Docket: 2006-1176(IT)G

BETWEEN:

L'INDUSTRIELLE ALLIANCE,
ASSURANCES ET SERVICES FINANCIERS INC.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

Appeals heard on December 6 and 7, 2007, at Montréal, Quebec

Before: The Honourable Justice Louise Lamarre Proulx

Appearances:

Counsel for the Appellant:	Philip Nolan Luc Pariseau
Counsel for the Respondent:	Daniel Marecki

JUDGMENT

The appeals from the assessments made under the *Income Tax Act* for the 1997 and 1998 taxation years are allowed, with costs, and the assessments are referred back to the Minister of National Revenue for reconsideration and reassessment in accordance with the attached Reasons for Judgment.

Signed at Ottawa, Canada, this 10th day of January 2008.

"Louise Lamarre Proulx"

Lamarre Proulx J.

Translation certified true
on this 22nd day of February 2008.

François Brunet, Revisor

Citation: 2008TCC15
Date: 20080110
Docket: 2006-1176(IT)G

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REASONS FOR JUDGMENT

Lamarre Proulx J.

[1] The issue in the instant case is whether the Minister of National Revenue ("the Minister") may declare that a share subscription agreement in which shares were purchased at market value, and a brokerage agreement in which the new owner of the shares was registered and a broker was chosen, are without legal effect since the ownership of the shares, or at least the right to the dividends, was not transferred. The Minister is not contesting the validity or veracity of these agreements, which were entered into as part of a large bonded debt incurred by the Appellant in order to increase its capital.

[2] The taxation years in issue are 1997 and 1998. The statutory provision which the Appellant invokes is subsection 138(6) of the *Income Tax Act* ("the Act") under which a life insurer may deduct dividends received from a taxable Canadian corporation if it included those dividends in computing its income. The Minister

submits that the Appellant is not entitled to this deduction because the dividend income does not belong to the Appellant and was not included in its income.

[3] Yvon Côté, the Appellant's Vice President and Executive Director, Finance and Investment, testified for the Appellant. He explained that the Appellant was in a difficult and even precarious financial situation in 1992 as a result of the acquisition of Trustco Général. The Appellant had to let go of that company, and sustained losses in excess of $100 million. The Appellant's liabilities ballooned, and the ratio of capital available to capital required became dangerously low.

[4] According to the witness, the Appellant needed to find a way to increase its available capital. It turned to the Caisse de dépôt et placement du Québec ("CDPQ"). In view of its low capital available and the regulatory environment for mutual life insurance companies, it would have been too onerous to turn to the private sector. After 18 months of arduous discussions, the Appellant and the CDPQ agreed on a financial plan that the insurance directorate of Quebec's Inspecteur général des institutions financières ("IGIF"), which was overseeing the situation, considered satisfactory.

[5] In accordance with this plan, the Appellant issued a subordinated debenture in the amount of $60 million to the CDPQ on January 24, 1994. On the same day, the Appellant purchased Domtar bonds and Power Financial Corporation shares from the CDPQ at market value for $60 million. Closing documents described at tab 27 of Exhibit I-1 were signed that day. The main documents in the instant dispute are the debenture, Schedule A, the Share Subscription Agreement, and the Brokerage Agreement.

[6] In an initial letter dated October 26, 1993 (Exhibit A-1, tab 54), the IGIF accepted the CDPQ's proposal to invest $60 million in the Appellant's capital. On January 14, 1994, the final version of the investment proposal was accepted in the following terms (Exhibit I-1, tab 35):

> [TRANSLATION]
>
> . . .
>
> I have reviewed the documents that you sent me on December 23, 1993 with respect to the above-referenced subject, and I understand that they constitute the final version of your proposed agreement with the CDPQ.

> Over the last few months, my staff has analysed different versions of your proposal, and various discussions took place with your representatives and the CDPQ's. These meetings made it possible to clarify and rework certain sections of the documents submitted.
>
> In this regard, I would like to inform you that I am satisfied with the results of the discussions concerning events of default, the impact of such events on the repayment of the debentures, and referrals to regulators. In addition, as I have already told you, the debentures will not be redeemable prior to maturity without my prior consent.
>
> Consequently, I confirm that the value of the debenture will be considered in the capital base, and that the straight-line depreciation to which the debenture will be subject for the purposes of the statutory surplus tests shall commence five (5) years prior to maturity.
>
> This acceptance supersedes the one contained in my letter of October 26, 1993, which was based on earlier documents that were subsequently amended.
>
> . . .

[7] This letter confirms that, from the IGIF's perspective, the value of the debenture will be factored into the Appellant's capital base.

[8] Clauses 2 and 3 of the Subscription Agreement (Exhibit I-1, tab 36) describe the purchase of the debenture by the CDPQ and the Appellant's use of the amount invested by the CDPQ.

[9] I quote clauses 2 and 3:

> [TRANSLATION]
>
> 2. PURCHASE OF DEBENTURE
>
> Subject to the terms and conditions hereof, and based on the representations and warranties made by the Company herein, the Company agrees to issue and sell the Debenture to the CDPQ this day, and the CDPQ agrees to subscribe for it and purchase it from the Company for the subscription price of $60,000,000.

3. USE OF INVESTMENT PROCEEDS

The Company shall use the entire proceeds of the Debenture investment for the initial establishment of the Portfolio. In this regard, the Company agrees to purchase this day the following Initial Securities from the CDPQ, and the CDPQ agrees to sell same to the Company, for the prices set out below, which represent the market value of the Initial Securities as at January 21, 1994:

Description of securities	**Total selling price**
• Domtar Inc. 8% convertible debentures with an aggregate par value of $20,000,000	$29,650,000
• 895,941 common shares of Power Financial Corporation	$30,350,000
	$60,000,000

[10] Since the Respondent focuses on certain sections of this agreement in her attempt to show that the Appellant did not own the shares, or that, if it did, it did not own the income therefrom, I quote clauses 6.2 and 6.3, part of clause 6.4, and clauses 6.5, 6.12, 6.14 to 6.16, and 7.2:

[TRANSLATION]

6.2 The Portfolio shall initially consist of the Initial Securities. The Company grants the CDPQ the exclusive right to choose possible changes to the Portfolio mix and agrees not to change it on its own except (i) in accordance with a Request (within the meaning of clause 6.4 below) or (ii) with the prior written agreement of the CDPQ. However, the Company may modify the Portfolio mix to the extent necessary if the CDPQ fails to make a Request under clause 6.11 below.

6.3 The Company is the owner of the Portfolio Securities and Portfolio Cash and shall not hypothecate, charge or subject them to any other security.

6.4 Further to the right granted by the Company to the CDPQ under clause 6.2, the CDPQ may occasionally ask that the Portfolio mix be changed or that the rights set out in clauses 6.12 and 6.13 be exercised in a certain manner. In order to do so, it shall issue a written request ("a Request") setting out the contemplated transaction or the manner in which the rights are to be exercised, specifying, at its election,

. . .

6.5 Unless the CDPQ decides to be responsible for them, the purchase price of Securities to be included in the Portfolio shall be borne by and taken from the Portfolio Cash, or, in the case of an exchange, shall be effected by the delivery of Portfolio Securities. Unless the CDPQ decides to assume them, all the Broker's fees, all safekeeping expenses for the Portfolio Securities and all transaction charges payable to market intermediaries in respect of Portfolio transactions further to Requests shall also be borne by and taken from the Portfolio Cash (if necessary, by selling certain Portfolio Securities chosen by the CDPQ); in the event of insufficiency the CDPQ shall provide the funds required to pay for the Securities acquired or pay the brokerage or safekeeping expenses and all transaction charges payable to market intermediaries.

. . .

6.11 If the Company is required, by reason of any legislation or rules applicable to the Company, to reduce its holdings of an issuer's Securities, it shall first divest itself of the Securities that it holds but that are not part of the Portfolio, and if such divestiture is insufficient, the CDPQ shall, within two (2) business days after the Company notifies it in writing of such insufficiency, make a Request for Portfolio Securities to be sold in such a manner as to ensure the Company complies with the new holding rules.

6.12 All rights attached to the Portfolio Securities (including voting rights and the right to accept a takeover or exchange offer) shall be exercised by the Company (directly or through the Broker) in accordance with the Requests. If no Requests in this regard are made, the Company and the Broker shall refrain from exercising such rights. The Company (or the broker, on the Company's instructions) may refrain from exercising the voting rights associated with a Portfolio Security (but not exercise the voting right in a manner contrary to the Requests) if the subject on which the Company is called upon to vote as a shareholder is known to be the subject of serious opposition by shareholders or certain directors of the issuer concerned.

. . .

6.14 The Company shall not be entitled to any management, transaction or other fee in relation to the Portfolio.

> 6.15 Under no circumstances shall the CDPQ be liable to anyone whatsoever for the manner in which it exercises its rights under section 6 hereof, and, for greater clarity, it shall not be liable to anyone whatsoever for any decrease in the value of the Portfolio for any reason whatsoever. The provisions of this clause 6.15 shall have no effect on the Bearer's obligations under the Debenture.
>
> . . .

[11] What these clauses expressly state is that the CDPQ has the exclusive right to manage the portfolio. The Appellant, as the portfolio's owner, retains the power to modify the portfolio mix, but this power is tied to the CDPQ's management power. The only way that the Appellant can modify the mix on its own initiative is in cases contemplated by clause 6.11 of the Agreement, if the CDPQ fails to issue a Request concerning a certain transaction required by any legislation or rule applicable to the Appellant.

[12] Clause 7.2 of the Agreement was the clause that had the greatest influence on the Minister's officer. It is part of section 7 of the Agreement, entitled [TRANSLATION] "Income and Portfolio Appreciation", and it provides:

> [TRANSLATION]
>
> 7.2 Subject to subparagraph 8.5.1 of the Debenture, as long as the Debenture is outstanding, the Company shall, immediately upon receiving Income, pay the CDPQ an amount equal to the Income received. Such payment shall be made by the Company (or the Broker acting on its behalf) no later than the business day after the day in which the Company receives (through the Broker) the Income in question. Except where the CDPQ directs otherwise, the payment to the CDPQ shall be made in cash, and, where applicable, by the delivery of the assets or securities received as Income.

[13] The clause provides that the Appellant must pay the CDPQ an amount equal to the income received.

[14] However, it should be noted that section 8 of the Subscription Agreement states that as long as the debenture is outstanding, the CDPQ is entitled to appoint a director to the Appellant's board at any time. The director may also sit on the Appellant's management and audit committees.

[15] Section 5 of the Brokerage Agreement (Exhibit I-1, tab 42), provides that all the portfolio securities shall be registered under the broker's name for the company (i.e. the Appellant) or, in certain cases, under the company's name.

[16] Section 6 of that agreement provides once again that the company owns the securities. The same stipulation is already made in section 6.3 of the Subscription Agreement.

[17] Section 6 of the Brokerage Agreement reads:

> 6. Portfolio Ownership
>
> The Company is the owner of the Portfolio Securities and Portfolio Cash, and consequently, the Broker shall not use them in any manner, hypothecate, charge or subject them to any security whatsoever, or effect compensation in any manner without the prior agreement of the Company and the CDPQ. Further, the Broker shall not transfer or deliver the Portfolio Securities or Portfolio Cash to the Company or any other person without the prior consent of the CDPQ, except (i) to the CDPQ in accordance with this Agreement or (ii) where the Broker is required to do so under a provision of an applicable statute or regulation or under a judgment of a competent court from which no appeal is available.
>
> In addition, the Company shall not hypothecate, charge or subject the Portfolio Securities or Portfolio Cash to any security whatsoever. Immediately upon becoming aware of the creation or attempted creation of a hypothec, charge or security by the Company or a third party, the Broker shall notify the CDPQ, and, if applicable, the Company.

[18] Appendix A is a document that forms an integral part of any certificate containing the subordinated debenture. It is entitled [TRANSLATION] "Appendix A to the Industrial Alliance Life Insurance Company Subordinated Debenture". Its definitions in section 1, [TRANSLATION] "Interpretation", refer to the Subscription and Brokerage Agreements. Appendix A is significant in its own right. It is appended to the Subscription Agreement (tab 36) and the Brokerage Agreement (tab 42). As an appendix to the debenture, it can be found at tab 40 of Exhibit I-1.

[19] Section 3 of Appendix A sets out the [TRANSLATION] "Interest Terms and Conditions". There is basic interest, profit-sharing interest, and additional interest. Section 4 provides for the [TRANSLATION] "Repayment Method upon Maturity". The method provided for is that the CDPQ guarantees the $60-million value of the portfolio.

[20] Section 6 of Appendix A is about the [TRANSLATION] "Subordinate Nature of the Debentures". Payment of the principal and any interest on the debenture is subject to the prior settlement of higher ranking debts. Section 6.2 sets out the order of payment upon dissolution, winding-up, reorganization or measures involving the Company by reason of its bankruptcy or insolvency, or by reason of reorganization brought about by insolvency.

[21] I must immediately state that, on reading this clause, I do not see anything that would enable me, or a court sitting in bankruptcy, to assert that the Appellant's assets do not include full ownership of the portfolio securities in issue, and that the securities cannot be applied in their entirety to the payment of the Appellant's higher-ranking debts.

[22] It should also be noted that the CDPQ and the Appellant presented their respective assets in accordance with the agreements made under the investment and recovery plan. One can see that the debenture is listed in the CDPQ's assets, whereas the shares transferred to the Appellant are no longer included as assets. The shares acquired from the CDPQ are listed under the Appellant's assets.

[23] On April 27, 2001 (Exhibit I-1, tab 17), the auditor referred the Appellant's file to the tax avoidance manager. I quote the main paragraphs of the referral letter:

> [TRANSLATION]
>
> . . .
>
> In summary, the corporation is claiming a deduction for dividends received from taxable corporations under subsection 138(6) of the ITA ($1,538,417 in 1997 and $985,805 in 1998). In our opinion, this series of transactions is abusive within the meaning of the *Income Tax Act*.
>
> We question the accounting entries in its books, whether a true loan existed, and whether a part of the interest is deductible. We believe that tax avoidance concepts (agency and/or "substance over form") may be applicable.

> We refer you to the statement of facts and the analysis of the transaction contained in the attached letter from Michel Lévesque. We can confirm that, in the past, the Canada Customs and Revenue Agency did not contest the deductibility of these dividends from the Caisse de Dépôt du Québec.

[24] On January 9, 2002 (Exhibit I-1, tab 19), the Tax Avoidance Section responded that the use of the Act's anti-avoidance provisions [TRANSLATION] "**could not be contemplated**" because it would be difficult to [TRANSLATION] "**reasonably** argue that the transaction was not undertaken or arranged primarily for *bona fide* purposes." (Emphasis added.)

[25] On January 25, 2002, the auditor issued a draft assessment for the 1997 and 1998 taxation years (Exhibit A-1, tab 60). The opening paragraph reads:

> [TRANSLATION]
>
> . . .
>
> 1. The referral of the dividend deduction issue to the Tax Avoidance Section ended on January 9, 2002, and you were notified of this situation by Jacques Renaud. It remains our view that Industrial Alliance did not have the right to the income, and therefore could not claim the dividend deduction under section 138(6) of the ITA.
>
> . . .

[26] Based on the Report on Objection dated January 27, 2006, at tab 10 of Exhibit I-1, the amount disallowed in 1997 was $1,538,417, and the amount disallowed in 1998 was $985,505.

[27] The appeals officers' perspective on the right to the income, set out at page 152 of the same report, is interesting to read:

> [TRANSLATION]
>
> (5) The right to income: The *Minet* case
>
> Based on the finding of Stone J.A. in *Minet* (98 DTC 6364), in determining whether an amount constitutes income under section 9(1) of the ITA, it is important that the amount be completely earned by the owner, in that the owner is entitled to dispose of it as he sees fit or has an "absolute right" to it. Based on the documents before us in this matter, IA must, on the following day, remit an amount equal to the income earned/received in respect of the investments acquired with the proceeds of the debenture issue. In our opinion, IA is so limited that it cannot be considered to have an absolute right over the investment income, and thus, is not the recipient thereof.
>
> The taxpayer in *Minet* had some freedom with respect to the management of the premiums and commissions before the premiums were remitted to the American insurers and the commissions were remitted to the American brokers. Nonetheless, the ultimate or absolute right to the income was the important factor; under the law, Minet was required to remit the commission income amounts to American brokers, and thus, in the final analysisend result, did not have the absolute right to the income. Hence, at the end of the day, it was ruled that the commission income did not belong to Minet.
>
> IA did not even briefly have enjoyment of the income from the securities, since an "amount equal" to the income was payable on the next business day. Thus, in our opinion, it stands even more to reason that IA has no right to the income derived from the securities "acquired" following the issuance of the debenture.

[28] The Notice of Confirmation dated February 2, 2006, can be found at tab 9 of Exhibit I-1. It reads:

> [TRANSLATION]
>
> NOTICE OF CONFIRMATION BY THE MINISTER
>
> …
>
> Industrial Alliance Life Insurance Company does not have the right to the income, including dividend income, from the securities related to the $60M debenture issued to the Caisse de Dépôt et Placement du Québec in 1994. Consequently, you cannot deduct the taxable dividend amounts under subsection 138(6) of the *Income Tax Act*.

[29] On the same day, the appeals officer sent the Appellant an explanatory letter (Exhibit I-1, tab 11). I quote from the paragraphs entitled "The *Minet* case" and "An equal amount":

> [TRANSLATION]
>
> . . .
>
> The *Minet* case
>
> Our position that the revenue does not belong to the corporation is based on the *Minet* case (98 DTC 6364). There, the taxation of the broker Minet's commissions was set aside by the Federal Court of Appeal because, by law, the commissions had to be paid to an American broker; the risk insurers were American. Between the time that the premiums were collected, and the time that the brokers and insurers had to be paid, Minet was free to make the funds grow, manage them, and keep the revenues thereby derived. Despite this fact, the Court held that the commission income did not belong to Minet because he did not have an absolute right over the commissions. With Industrial Alliance, there is no opportunity to manage or use the income from the securities in any way, and an immediate and equal liability to the CDPQ is created and payable on the next business day.

An equal amount

> You stated that the actual income was not paid to the CDPQ, but that an equal amount was payable under clause 7.2 of the Subscription Agreement so that the income remained in the corporation. Since an immediate and equal liability is created at the moment that the income is received, it would be difficult for us not to consider that the income is ultimately being returned to the CDPQ. In addition, we note that section 12 of the Brokerage Agreement addresses the broker's handling of the revenues and the registration of these revenues and transfers to the CDPQ; there is no reference to an equal amount.

[30] André Gauthier, the lead auditor in the instant matter, explained the Minister's position. In the Subscription Agreement, the Appellant agreed to remit to the CDPQ an amount equal to the dividends received. Thus, the economic effect in relation to the acquired shares is zero. This is why the Minister was of the view that the share purchase contract was not a share purchase contract and that there was no transfer of ownership. It is true that the Appellant was the registered owner, but, in the Minister's determination, it was not the true owner. Perhaps it had the bare ownership, but, in his opinion, it was certainly not entitled to the income. It received dividends so that it could remit them to the CDPQ, which continued to own the shares, or at least the right to the dividends. Nevertheless, the auditor did not believe that there was any deception or sham involved.

[31] Before closing the discussion of the evidence, I would like to refer to the press releases issued by the Caisse and the Appellant on February 22, 1994 (Exhibit I-1, tab 50). They succinctly set out the different legal characteristics of the CDPQ's $60-million investment and the correlative increase in the Appellant's capital.

[32] Here are a few paragraphs from the press release:

> The issue of capital comes from a participating subordinated debenture at variable interest. The debenture will mature in 2004 and is redeemable after 5 years at the option of the issuer.
>
> The expected return by the holder is composed of three items: a basic annual return, a variable return which depends on the portfolio's performance and a participation in the Company's profits, subject to a maximum limit.

> "The negotiations between the two institutions have allowed the Caisse to develop an innovative financial tool which financial institutions can use to their advantage, whether they be stock corporations, mutual companies or cooperatives," Mr. Savard explained. He went on to say that "this innovative financial tool lies in the creation of a type of debenture indexed to the value of a portfolio in the stock, bond or money markets. The return on the debenture doesn't only depend on the financial tool, but also on the behaviour of the underlying securities. This innovative tool should provide added value to the Caisse."
>
> Mr. Garneau indicated that "this additional capital, combined with Industrial-Alliance's $27.2 million profit for 1993, will provide the company with more room to manoeuvre in order to continue our growth at a more vigorous rate. This capital will also allow the company to meet the capital requirements set out by the Canadian Life and Health Insurance Compensation Corporation (CompCorp) with an even more considerable margin than before, as well as those that have just been announced by the Inspector General of Financial Institutions of Quebec, which will officially come into effect in 1995 and will take full effect after a transition period."

Analysis and conclusion

[33] Subsection 138(6) of the Act reads:

> **138(6) Deduction for dividends from taxable corporations** – In computing the taxable income of a life insurer for a taxation year, no deduction from the income of the insurer for the year may be made under section 112 but, except as otherwise provided by that section, there may be deducted from that income the total of taxable dividends (other than dividends on term preferred shares that are acquired in the ordinary course of the business carried on by the life insurer) included in computing the insurer's income for the year and received by the insurer in the year from taxable Canadian corporations.

[34] From the outset of his oral submissions, counsel for the Respondent stated that the Respondent was not arguing that the agreements were deceptions or shams. Rather, the Respondent submitted, the ownership of the Portfolio Securities was not transferred by the agreements, and if a transfer of some kind took place, it was merely a transfer of the bare ownership, not a transfer of the right to the income.

[35] Counsel for the Appellant referred to the decision of the Supreme Court of Canada in *Continental Bank of Canada v. The Queen* (*sub nom. Continental Bank Leasing Corp. v. Canada*), [1998] 2 S.C.R. 298, [1998] S.C.J. No. 63 (QL), a decision written by Bastarache J., arguing that if the sham doctrine does not apply, the agreements must be given the legal effects sought by the parties.

[36] I quote from paragraph 21 of that decision:

> 21 After it has been found that the sham doctrine does not apply, it is necessary to examine the documents outlining the transaction to determine whether the parties have satisfied the requirements of creating the legal entity that it sought to create. The proper approach is that outlined in *Orion Finance Ltd. v. Crown Financial Management Ltd.*, [1996] 2 B.C.L.C. 78 (C.A.), at p. 84:
>
> > The first task is to determine whether the documents are a sham intended to mask the true agreement between the parties. If so, the court must disregard the deceptive language by which the parties have attempted to conceal the true nature of the transaction into which they have entered and must attempt by extrinsic evidence to discover what the real transaction was. There is no suggestion in the present case that any of the documents was a sham. Nor is it suggested that the parties departed from what they had agreed in the documents, so that they should be treated as having by their conduct replaced it by some other agreement.
> >
> > Once the documents are accepted as genuinely representing the transaction into which the parties have entered, its proper legal categorisation is a matter of construction of the documents. This does not mean that the terms which the parties have adopted are necessarily determinative. The substance of the parties' agreement must be found in the language they have used; but the categorisation of a document is determined by the legal effect which it is intended to have, and if when properly construed the effect of the document as a whole is inconsistent with the terminology which the parties have used, then their ill-chosen language must yield to the substance.

[37] What legal effects did the CDPQ and the Appellant intend? The CDPQ invested $60 million in a debenture issued by the Appellant. The Appellant was required, on the same day, to use the entire amount to purchase shares and bonds held by the CDPQ for their market value.

[38] In my opinion, to claim that the agreement for the purchase and sale of shares was not a true purchase and sale agreement amounts to saying that the entire financial plan was a scam: $60 million was not lent to the Appellant, and the Appellant did not use these funds to purchase shares. Indeed, market value for the full ownership of shares will not be paid if full ownership is not acquired. If the only thing that is acquired is bare ownership, what is its market value? Why did the parties enter into a brokerage agreement if the CDPQ remained the usufructuary?

[39] It is true that the Appellant conceded an almost exclusive right to manage the Portfolio Securities. It is also true that an amount equal to the income generated by the shares was paid to the CDPQ. These were terms negotiated as part of a substantial loan. Based on these terms, can one conclude that the full ownership of the shares was not transferred, when the entire plan was an injection of capital?

[40] The authenticity of the investment and recovery plan was not questioned. Thus, it must be taken as a given that the Appellant received $60 million from the CDPQ and that this money was used under the plan to purchase the full ownership of the shares and bonds in issue for the market value of such ownership. These were shares and bonds that it fully owned and could lawfully include in its assets. That was the purpose of the 18 months of negotiation: an increase in the capital base.

[41] It must also be borne in mind that the CDPQ and the Appellant presented their respective assets in accordance with the agreements signed. Moreover, in order to protect its investment, the CDPQ demanded the right to have a director on the Appellant's board.

[42] Since the decision of the Federal Court of Appeal in *Minet v. Canada*, [1998] F.C.J. No. 697 (QL) played a determinative role in the auditors' decision, I will address it briefly. The decision essentially turned on the fact that the Appellant had no legal right to the commissions. I refer to paragraph 36 of the judgment:

> 36 If I am correct in the foregoing analysis, I do not see how as the Tax Court Judge stated the appellant "received" the commissions or acquiesced in their payment to MIPI and Bowes so as to keep them "in the family", or that the appellant exercised a "degree of control and dominion" over them. The three companies were entirely distinct legal entities. The U.S. state laws simply prohibited U.S. insurers from paying commissions to an unlicensed broker like the appellant. In my view, therefore, the appellant could not and never did become the owner of or have any absolute right to the commissions. Accordingly, the commissions did not constitute income from its business. The relevant foreign laws prevented that from occurring. As we have seen, the case law both in Canada and the United States strongly suggests that an amount is not to be regarded as the income of a taxpayer where he or she has no absolute ownership or dominion over it. This, it seems to me, is the situation in the case at bar.

[43] American laws forbade American insurers from paying commissions to unlicensed brokers like the appellant in *Minet*. The Federal Court of Appeal was therefore of the opinion that he could not be in possession of the commissions or have any right over them, and thus, that the commissions were not income from his business.

[44] The situation in the case at bar is that the Appellant is entitled to the dividends if we respect the parties' intentions with respect to the agreements between them. As the Supreme Court has held in *Continental Bank*, *supra*, the legal effects intended by the parties in their agreements must be respected unless those agreements are a deception or sham *vis-à-vis* the Minister. Here, however, the Respondent admits that there is no sham. Thus, the agreements must be respected. The receipt of the dividend and the payment of an equal amount are two separate transactions having distinct legal sources, and each transaction must be subject to its own tax treatment.

[45] In conclusion, the Appellant owned the Portfolio Securities, and, as the owner of the shares, it received the dividends declared on those shares and included them in its income. It is entitled to the deduction provided in subsection 138(6) of the Act in respect of those dividends.

[46] The appeals are accordingly allowed, with costs.

Signed at Ottawa, Canada, this 10th day of January 2008.

"Louise Lamarre Proulx"

Lamarre Proulx J.

Translation certified true
on this 22nd day of February 2008.

François Brunet, Revisor

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