

Docket: 2007-3417(IT)G

BETWEEN:

LES ENTREPRISES RÉJEAN GOYETTE INC.,

Appellant

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

Appeals heard on December 10, 2008, at Montreal, Quebec.

Before: The Honourable Justice Réal Favreau

Appearances:

Counsel for the appellant: Rodrigue E. Lévesque
Counsel for the respondent: Vlad Zolia

JUDGMENT

The appeals from the reassessments dated July 21, 2005, by which the Minister of National Revenue disallowed the deduction of management fees in the amount of \$80,000 for each of the 2002 and 2003 taxation years are dismissed with costs in accordance with the attached Reasons for Judgment.

Signed at Ottawa, Canada, this 30th day of June 2009.

"Réal Favreau"

Favreau J.

Translation certified true
on this 30th day of September 2009.

Erich Klein, Revisor

Citation: 2009 TCC 351
Date: 20090630
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LES ENTREPRISES RÉJEAN GOYETTE INC.,

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REASONS FOR JUDGMENT

Favreau J.

[1] These are appeals from reassessments dated July 21, 2005, by which the Minister of National Revenue (the Minister) disallowed the appellant's deduction of management fees in the amount of \$80,000 paid to 2744-2870 Québec Inc. for each of the 2002 and 2003 taxation years.

[2] During the taxation years at issue, the appellant operated a residential housing construction business. The appellant was a wholly owned subsidiary of 124660 Canada Ltd., the sole shareholder of which was Réjean Goyette.

[3] 2744-2870 Québec Inc. was also a wholly owned subsidiary of 124660 Canada Inc. It was in the business of purchasing land suitable for urban development and of preparing building lots for the appellant. The appellant acquired lots for \$415,000 and \$436,000 from 2744-2870 Québec Inc. during the 2002 and 2003 fiscal years respectively.

[4] Réjean Goyette testified at the hearing, explaining that 2744-2870 Québec Inc. paid for the usual development work on the lots, while the appellant paid for any out of the ordinary development work, which could involve canalizing a stream in a flood-prone area, installing services on lots with unstable ground or constructing a

retaining wall to prevent soil erosion. Mr. Goyette also explained that the performance of such out of the ordinary work first had to be approved by 2744-2870 Québec Inc. because it was generally carried out before title to the lots passed to the appellant, which usually occurred when the lots had been excavated for construction.

[5] Réjean Goyette personally supervised the development work on the lots. Having technical training in civil engineering, he was entirely qualified to do so. Mr. Goyette stated that he devoted about 50% of his time to 2744-2870 Québec Inc.'s affairs. He also confirmed that he received no salary from 2744-2870 Québec Inc. in 2002 or 2003, but that he did receive an \$87,500 salary from the appellant in both 2002 and 2003.

Analysis

[6] The issues are whether the \$80,000 in management fees paid by the appellant during the 2002 and 2003 taxation years may be deducted in computing its income by virtue of the fact that they were incurred for the purpose of gaining or producing income from a business, and if so, whether these management fees are reasonable in the circumstances. Counsel for the respondent relies, in particular, on paragraph 18(1)(a) and section 67 of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) as amended (the Act). Those provisions read as follows:

Section 18: General limitations

(1) In computing the income of a taxpayer from a business or property no deduction shall be made in respect of

(a) **General limitation** – an outlay or expense except to the extent that it was made or incurred by the taxpayer for the purpose of gaining or producing income from the business or property;

Section 67: General limitation re expenses

In computing income, no deduction shall be made in respect of an outlay or expense in respect of which any amount is otherwise deductible under this Act, except to the extent that the outlay or expense was reasonable in the circumstances.

[7] The evidence discloses that the appellant paid 2744-2870 Québec Inc. \$60,000 in management fees in regard to the fiscal year ending on August 31, 2000, and \$80,000 in management fees in regard to the fiscal years ending on August 31, 2001, August 31, 2002, and August 31, 2003. That practice was discontinued as of

September 1, 2003. 2744-2870 Québec Inc. used the management fees received from the appellant to offset its non-capital losses incurred in the course of the previous taxation years. At the start of the 2002 fiscal year, the appellant had a non-capital loss balance of \$462,181, while, by the end of the year, that loss balance had shrunk to \$208,612. By the end of the 2003 fiscal year, the appellant's non-capital loss balance was zero. Given these facts, it seems evident that the appellant paid the management fees in order to use some of its income to offset the losses of 2744-2870 Québec Inc. Such planning is not objectionable in itself, as long as a true consideration has been given by the company receiving the management fees, the amount of the fees corresponds to the fair market value of the services obtained considering that the two companies in question are related, and the documentation is adequate.

[8] In regard to the documentation concerning the appellant's payment of the management fees, the evidence showed that no agreement providing for the provision of services and the payment of management fees existed between the appellant and 2744-2870 Québec Inc. No corporate resolution authorizing the provision of services and the payment of management fees was adduced in evidence at the hearing. The only documentary evidence submitted that proves that services were provided and the management fees were paid were two invoices of 2744-2870 Québec Inc. dated August 31, 2002, and August 31, 2003 respectively, that is, the last day of the fiscal year of the companies in question. Those invoices have little probative value because they do not provide any information on the nature of the services provided, on the number of hours spent providing the services to the appellant or on the persons who provided the services. The following is the description of the invoice dated August 31, 2002:

[TRANSLATION]

Management fees for the 2002 fiscal year (from 01/09/01 to 31/08/02).

And the following is the description of the invoice dated August 31, 2003:

[TRANSLATION]

Management fees for the 2003 fiscal year (from 01/09/2002 to 31/08/2003).

The amount of the management fees on each invoice is \$80,000 plus applicable taxes.

[9] In response to an undertaking given at Réjean Goyette's examination for discovery, the appellant produced invoices relating to the out of the ordinary work that was performed under Mr. Goyette's supervision during the 2002 and 2003 fiscal

years and with respect to which the appellant was invoiced for management fees of \$80,000 per year. An analysis of those invoices showed that for 2002 there were 71 invoices totalling \$54,818.12 before tax, while for 2003 there were 48 invoices totalling \$55,737.04 before tax. That analysis reveals that the fees of \$80,000 per year invoiced to the appellant greatly exceeded the cost of the out of the ordinary work supervised by Mr. Goyette. On the appellant's financial statements, the cost of the out of the ordinary work was first entered in the [TRANSLATION] "inventory of houses" account. Once the houses were sold, it was entered under either the [TRANSLATION] "construction costs" or the [TRANSLATION] "other direct expenses" item.

[10] In his testimony, Réjean Goyette stated that the amount of the management fees invoiced to the appellant was based on the time that he spent supervising the out of the ordinary work, that is, 50% of his time. That statement in Mr. Goyette's testimony contradicts the representations made at the objection stage by the appellant's auditors. On February 2, 2007, those auditors filed a schedule taken from the file of 2744-2870 Québec Inc. for 2002. The schedule showed that the amount of the management fees was determined on the basis of the appellant's cost of construction of the houses for that year, that is, it 2% of \$4,077,129. It is strange, to say the least, that the amount of the management fees was based on different factors, namely, the cost of constructing the houses versus the time Mr. Goyette spent supervising the out of the ordinary work.

[11] Another particularity of this case is that the person who provided the services was both president and director of the two companies involved. At the hearing, no evidence was submitted that could have clarified the mandate of Mr. Goyette and the party he worked for when supervising the out of the ordinary work. Mr. Goyette received wages only from the appellant. The out of the ordinary work was paid for by the appellant, but carried out on lots belonging to 2744-2870 Québec Inc. It seems to me that the costs of supervising the out of the ordinary work should have been treated the same way as the cost of the out of the ordinary work itself, that is, they should have been paid directly by the appellant. In reality, that was likely the case, considering that Mr. Goyette received remuneration of \$87,500 annually from the appellant. This reasoning would lead to the conclusion that the deduction of the management fees would be tantamount to a double deduction of the same expense that was paid twice.

[12] During the years at issue, 2744-2870 Québec Inc. did not operate a business providing management services. According to its financial statements, that company did not incur operating expenses or current expenses associated with the supervision

of out of the ordinary work. During 2002 and 2003, 2744-2870 Québec Inc. had only three employees, namely, Réjean Goyette's spouse and two daughters, and their wages totalled \$20,000 per year.

[13] As well, evidence was submitted showing that the appellant did not pay management fees to the group's other companies that were also developing lots in the years 2000 to 2004, namely, 9094-6708 Québec Inc. and 88933 Canada Inc.

[14] In light of the foregoing, I conclude that the appellant did not demonstrate, on the balance of probabilities, that it had incurred the management fee expense for the purpose of earning income. The payment of the management fees appears to me to be, rather, a tax planning scheme designed to take advantage of the non-capital losses incurred by 2744-2870 Québec Inc. before time ran out.

[15] The evidence adduced does not make it possible to find, with a sufficient degree of certainty, that the appellant did receive a true consideration for the \$80,000 paid annually as management fees. Considering that the supervision of the out of the ordinary work was ancillary to that work, it would have been normal for the appellant to pay the expenses associated with the supervision activities just as it paid the cost of the out of the ordinary work.

[16] The lack of any written or verbal agreement stating the terms and conditions of the services to be provided to the appellant, the cost of those services and the absence of the formalities that are required in order to create real legal obligations between the companies concerned lead me to believe that the management fees were paid by the appellant without the appellant being legally bound to do so. Consequently, those fees cannot be deducted in the computation of the appellant's income. The fact that 2744-2870 Québec Inc. had to approve or authorize the out of the ordinary work did not legally oblige it to pay for their supervision.

[17] For these reasons, the appeals are dismissed with costs, and it is not necessary to consider the reasonableness of the management fee expense incurred by the appellant.

Signed at Ottawa, Canada, this 30th day of June 2009.

"Réal Favreau"

Favreau J.

Translation certified true
on this 30th day of September 2009.

Erich Klein, Revisor

CITATION: 2009 TCC 351

COURT FILE NO.: 2007-3417(IT)G

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PLACE OF HEARING: Montreal, Quebec

DATE OF HEARING: December 10, 2008

REASONS FOR JUDGMENT BY: The Honourable Justice Réal Favreau

DATE OF JUDGMENT: June 30, 2009

APPEARANCES:

Counsel for the appellant: Rodrigue E. Lévesque

Counsel for the respondent: Vlad Zolia

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