

Docket: 2016-2885(IT)G

BETWEEN:

HLB SMITH HOLDINGS LIMITED,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on common evidence with the appeals of
Smith Family Trust (2001) (2016-4104(IT)G), *Wayne Smith*
(2016-4544(IT)G) and *Brenda Lee Brunelle* (2016-4568(IT)G)
on December 6, 2017 at Halifax, Nova Scotia

Before: The Honourable Justice Steven K. D'Arcy

Appearances:

Counsel for the Appellant: Brian K. Awad

Counsel for the Respondent: Stan W. McDonald

JUDGMENT

In accordance with the attached Reasons for Judgment:

1. The appeal with respect to section 160 made under the *Income Tax Act* is dismissed.
2. Costs are awarded to the Respondent.

Signed at Ottawa, Canada, this 30th day of April 2018.

“S. D’Arcy”

D'Arcy J.

BETWEEN:

SMITH FAMILY TRUST (2001),

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on common evidence with the appeals of
HLB Smith Holdings Limited (2016-2885(IT)G), *Wayne Smith*
(2016-4544(IT)G) and *Brenda Lee Brunelle* (2016-4568(IT)G)
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D’Arcy J.

BETWEEN:

WAYNE SMITH,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on common evidence with the appeals of
HLB Smith Holdings Limited (2016-2885(IT)G), *Smith Family Trust*
(2001) (2016-4104(IT)G) and *Brenda Lee Brunelle* (2016-4568(IT)G)
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“S. D’Arcy”

D’Arcy J.

BETWEEN:

BRENDA LEE BRUNELLE,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on common evidence with the appeals of
HLB Smith Holdings Limited (2016-2885(IT)G), *Smith Family Trust*
(2001) (2016-4104(IT)G) and *Wayne Smith* (2016-4544(IT)G)
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“S. D’Arcy”

D’Arcy J.

Citation: 2018 TCC 83
Date: 20180430
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HLB SMITH HOLDINGS LIMITED,

Appellant,

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Respondent;

Docket: 2016-4104(IT)G

AND BETWEEN:

SMITH FAMILY TRUST (2001),

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent;

Docket: 2016-4544(IT)G

AND BETWEEN:

WAYNE SMITH,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent;

Docket: 2016-4568(IT)G

AND BETWEEN:

BRENDA LEE BRUNELLE,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

D'Arcy J.

[1] Each of the four appellants has appealed an assessment under section 160 of the *Income Tax Act*. The assessments of HLB Smith Holdings Limited (the “Holding Company”) and the Smith Family Trust (2001) relate to the payment of dividends in 2007 and 2008 by Power Electric Systems Limited (the “Operating Company”) to the Holding Company and, in the case of the Smith Family Trust (2001), the subsequent payment of dividends by the Holding Company to that trust. The assessments of Wayne Smith and Brenda Lee Brunelle relate to subsequent distributions by the Smith Family Trust (2001) to each of Mr. Smith and Ms. Brunelle.

[2] I heard the four appeals together on common evidence.

I. Facts

[3] Most of the relevant facts are contained in the following Partial Statement of Agreed Facts filed by the parties with the Court:

PARTIAL STATEMENT OF AGREED FACTS

The Appellant and the Respondent, by their solicitors, agree to the following facts provided that: (1) such admissions are made for the purpose of these proceedings only; and (2) the parties are permitted to adduce additional evidence which is not contrary to these agreed facts.

1. The Appellant, HLB Smith Holdings Limited (“HLB”), was a Nova Scotia Company with its head office in Halifax, Nova Scotia.
2. The Appellant, Smith Family Trust (2001) (“SFT”), was a discretionary trust.
3. HLB was held solely by SFT.
4. The trustees [of] SFT were the Appellant, Wayne Smith (“Smith”) and Michael Scott (“Scott”).
5. Smith and the Appellant, Brenda Brunelle (“Brunelle”), were beneficiaries of SFT.

6. Smith and Brunelle were spouses within the meaning of the *Income Tax Act*.
7. Power Electric Systems Limited (“PES”) was a Nova Scotia Company involved in the electrical contracting business with its head office in Halifax, Nova Scotia.
8. PES was incorporated in 1997.
9. From its inception, Smith and Michael Scott (“Scott”) each held 50% of the shares of PES, and from 1998 to 2008 inclusive, annual renewal statements were filed with the Nova Scotia Registry of Joint Stock Companies indicating that Smith and Scott were the two directors and officers of PES.
10. At taxation year end 2004, Smith transferred all of his shares in PES to HLB and Scott transferred all of his shares in PES to the Scott Family Trust.
11. Between 2005 and 2008, the shares of PES were held equally by HLB and the Scott Family Trust.
12. Smith and Scott continued as the only directors and officers of PES until November, 2008.
13. During its taxation year ending May 31, 2007, PES paid dividends to HLB in the total amount of \$53,500.
14. During its taxation year ending May 31, 2008, PES paid dividends to HLB in the total amount of \$48,000.
15. The consideration paid by HLB for the transfer of the dividends in question was nil.
16. At the time of the transfer of dividends to HLB in its 2007 taxation year, PES was indebted to the Minister for unpaid corporate income taxes and accumulated interest in the amount of \$25,328.03 as at July 21, 2014.
17. At the time of the transfer of dividends to HLB in its 2008 taxation year, PES was indebted to the Minister for unpaid payroll deductions and penalties and interest in the total amount of \$18,400.50 as well as federal and provincial income tax in the total amount of \$29,599.50 as at July 21, 2014.
18. Upon receipt of dividends from PES in the taxation year ending May 31, 2007, HLB paid dividends to SFT in the total amount of \$53,500.00.
19. Upon receipt of dividends from PES in the taxation year ending May 31, 2008, HLB paid dividends to SFT in the total amount of \$46,000.00.

20. The consideration paid by SFT for the transfer of the dividends in question was nil.
21. In 2007, SFT distributed \$26,750.00 to each of Smith and Brunelle as beneficiaries of SFT.
22. In 2008, SFT distributed \$23,000.00 to each of Smith and Brunelle as beneficiaries of SFT.
23. The consideration paid by Smith and Brunelle for the transfer of funds from SFT was nil.

[4] The Appellant Wayne Smith testified during the hearing. He explained the history of the Operating Company, the Holding Company and the Smith Family Trust (2001).

[5] Mr. Smith and a Mr. Michael Scott incorporated the Operating Company in 1997. Prior to incorporating the Operating Company, Mr. Smith and Mr. Scott worked as electricians for a company called Metro Electric. At some point, they decided to start their own business of providing the services of electricians. They decided to carry on the business through the Operating Company.

[6] Once the Operating Company was incorporated, Mr. Smith and Mr. Scott held 50% of the shares of the Operating Company. In addition, from the time of the incorporation of the Operating Company until November 28, 2008, Mr. Scott and Mr. Smith were the only directors of the Operating Company. During this period, Mr. Scott was the President of the Operating Company and Mr. Smith was the Vice-President and Secretary. There were no other officers.

[7] The Partial Statement of Agreed Facts states at paragraph 10 that at the end of 2004 Mr. Smith transferred all of his shares in the Operating Company to the Holding Company and Mr. Scott transferred all of his shares in the Operating Company to a trust called the Scott Family Trust. The Smith Family Trust (2001) held all of the shares of the Holding Company.

[8] Mr. Smith testified that the Operating Company's accountant, Mr. Tony Howatt, suggested that Mr. Smith and Mr. Scott put this structure in place to allow for income splitting. He testified that he and Mr. Scott agreed that the Operating Company would pay each of them \$1,000 per week. Mr. Smith described the \$1,000 as a paycheque that one would call a dividend. In the Partial Statement of Agreed Facts, the parties agree that the amounts paid by the

Operating Company were dividends and that no consideration was paid for the transfer of any dividends.

[9] Mr. Smith testified that he and his spouse, the Appellant Ms. Brunelle, split the \$1,000 weekly payments. He received the \$1,000 every second week. Ms. Brunelle received the \$1,000 in each week that it was not paid to Mr. Smith.

[10] As can be seen from the Partial Statement of Agreed Facts, the \$1,000 weekly amounts were not paid directly by the Operating Company to either Mr. Smith or Ms. Brunelle. The Operating Company paid the amounts as dividends to the Holding Company. The Holding Company then paid the amounts as dividends to the Smith Family Trust (2001). The Smith Family Trust (2001) then distributed the amounts to Mr. Smith and Ms. Brunelle as beneficiaries of the trust. As noted in the Partial Statement of Agreed Facts:

The Operating Company paid dividends to the Holding Company of \$53,500 and \$48,000 in its taxation years ending on May 31, 2007 and May 31, 2008 respectively.

The Holding Company paid dividends to the Smith Family Trust (2001) of \$53,500 and \$46,000 in its taxation years ending on May 31, 2007 and May 31, 2008 respectively.

The Smith Family Trust (2001) distributed \$26,750 to each of Mr. Smith and Ms. Brunelle in 2007 and \$23,000 to each of Mr. Smith and Ms. Brunelle in 2008.

[11] It appears from Mr. Smith's testimony that his main responsibility with respect to the operation of the Operating Company was to supervise and/or work at various jobs. He attended at the Operating Company's offices each morning to do such things as sign cheques and help prepare job quotations. However, he spent most of his time working at clients' premises.

[12] Mr. Scott appears to have been responsible for most financial matters, including determining when the Operating Company should pay its accounts payable, which included amounts owing to the Canada Revenue Agency.

[13] Mr. Smith testified that he discovered, on or about November 28, 2008, that the Operating Company was insolvent and owed a significant amount in respect of

its taxes. He immediately resigned as an officer and director of the Operating Company.

II. The Law

[14] Section 160 reads, in part, as follows:

160.(1) Tax Liability re property transferred not at arm's length - Where a person has, on or after May 1, 1951, transferred property, either directly or indirectly, by means of a trust or by any other means whatever, to

...

(c) a person with whom the person was not dealing at arm's length

the following rules apply:

...

(e) the transferee and transferor are jointly and severally, or solidarily, liable to pay under this Act an amount equal to the lesser of

(i) the amount, if any, by which the fair market value of the property at the time it was transferred exceeds the fair market value at that time of the consideration given for the property, and

(ii) the total of all amounts each of which is an amount that the transferor is able to pay under this Act (including, for greater certainty, an amount that the transferor is liable to pay under this section, regardless of whether the Minister has made an assessment under subsection (2) for that amount) in or in respect of the taxation year in which the property was transferred or any preceding taxation year.

...

[15] The Federal Court of Appeal stated in *The Queen v. Livingston*, 2008 FCA 89, at paragraph 17, that the criteria to consider when applying section 160 to a fact situation such as the one here are as follows:

- 1) The transferor must be liable to pay tax under the Act at the time of transfer;
- 2) There must be a transfer of property, either directly or indirectly, by means of a trust or by any other means whatever;

- 3) The transferee must . . . be . . . [a] person with whom the transferor was not dealing at arm's length.
- 4) The fair market value of the property transferred must exceed the fair market value of the consideration given by the transferee.

[16] The only issue raised by the Appellants in the current appeals is whether the Holding Company dealt at arm's length with the Operating Company.

[17] Subsection 251(1) contains the rules for determining whether two parties are dealing at arm's length. It reads as follows:

251.(1) Arm's length - For the purposes of this Act,

(a) related persons shall be deemed not to deal with each other at arm's length;

(b) a taxpayer and a personal trust (other than a trust described in any of paragraphs (a) to (e.1) of the definition "trust" in subsection 108(1)) are deemed not to deal with each other at arm's length if the taxpayer, or any person not dealing at arm's length with the taxpayer, would be beneficially interested in the trust if subsection 248(25) were read without reference to subclauses 248(25)(b)(iii)(A)(II) to (IV); and

(c) in any other case, it is a question of fact whether persons not related to each other are, at a particular time, dealing with each other at arm's length.

[18] In the current appeals, each of the Holding Company and the Scott Family Trust held 50% of the shares of the Operating Company. As a result, neither the Holding Company nor the Scott Family Trust had *de jure* control of the Operating Company and thus the Holding Company was not related to the Operating Company for the purposes of subsection 251(2).¹

[19] Pursuant to paragraph 251(1)(c), it then becomes a question of fact whether the Holding Company and the Operating Company were dealing with each other at arm's length.

[20] Generally speaking, when determining whether parties to a transaction are dealing at arm's length, the Court considers if:

¹ See *Duha Printers (Western) Ltd. v. Canada*, [1998] 1 S.C.R. 795.

1. there was a common mind directing the bargaining for both parties;
2. they were acting in concert without separate interests; and
3. one party exercised *de facto* control over the other.

[21] Not all of the tests need to be satisfied in every case. Also, the listed factors are not exhaustive.²

III. Appellant's Argument

[22] In their written submissions, the Appellants state that, “the subject assessments are not authorized by section 160(1) because PESL [the Operating Company] and HLB [the Holding Company] were dealing at arm’s length with regard to the dividends paid by PESL [the Operating Company] in 2007 and 2008.”

[23] The Appellants argue that there was no common mind controlling the Operating Company and the Holding Company. Mr. Smith was a passive co-owner, accepting the decisions made by Mr. Scott with regard to dividends. They argue that Mr. Scott was the decision maker and that he controlled what dividends were paid by the Operating Company. Finally, the Appellants argue that Mr. Smith did not have an equal part in the decision to pay dividends nor did he make the decisions in concert with Mr. Scott.

IV. Disposition of the Appeals

[24] In my view, the fact situation before me is very similar to the fact situation before the Court in *Fournier (F.) v. M.N.R.*³ That appeal also involved an assessment under section 160 in respect of the payment of dividends. Judge Dussault stated the following in his reasons for judgment at pages 7201-7202 C.T.C., page 748 DTC:

For his part, Thurlow, J. of the Exchequer Court (as he then was) said in *Swiss Bank Corporation v. M.N.R.*, *supra*, at 437–48(D.T.C. 5241):

To this I would add that where several parties—whether natural persons or corporations or a combination of the two—act in concert,

² See *The Queen v. Remai Estate*, 2009 FCA 340, 2009 DTC 5188, at paragraphs 31 and 32.

³ [1991] 1 C.T.C. 2699, 91 DTC 746. See also *Gosselin v. R.*, [1997] 2 C.T.C. 2830.

and in the same interest, to direct or dictate the conduct of another, in my opinion the “mind” that directs may be that of the combination as a whole acting in concert or that of any one of them in carrying out particular parts or functions of what the common object involves.

We have here two principal shareholders in a company who are for all practical purposes the only real shareholders and directors and who decide together, on the advice of the company accountant, to withdraw profits made by the company in the form of dividends declared at year-end. It is agreed between them that in the meantime they will receive advances from the corporation and that the dividends to be declared subsequently will be for an amount equivalent to the advances received. A dividend of \$100,000 was in fact declared at year-end and the appellant admitted receiving his share in the form of advances throughout the year.

I cannot find a situation more suited to application of the concept of a non-arm's length transaction between unrelated persons, in that the company's two principal directors and shareholders apparently acted in concert and with a common economic interest to decide how they would withdraw the profits made by the company for their personal use. Acting both as directors of the company and its shareholders, they were in a position where the concept of not being at arm's length in fact as established by our courts could hardly be better applied. In this sense, therefore, I consider that Les Évaluateurs Fra-Mic Inc. was not at arm's length with the appellant at the time of the property transfer made during its 1983 taxation year, and that accordingly the respondent was right to apply subsection 160(1) of the Act to this transaction.

[25] I have reached a similar conclusion in these appeals. In my view, Mr. Smith and Mr. Scott acted in concert with respect to the payment of dividends by the Operating Company to the Holding Company and the Scott Family Trust.

[26] Mr. Smith, through the Smith Family Trust (2001) and the Holding Company, controlled 50% of the shares of the Operating Company, and Mr. Scott, through the Scott Family Trust, controlled the other 50% of the shares. More importantly, they were the only two directors and officers of the Operating Company.

[27] The Operating Company's chartered accountant, Mr. Howatt, put forward a tax plan to allow for income splitting between the Appellant and his family members. The plan included the payment of dividends by the Operating Company to the Holding Company and then by the Holding Company to the Smith Family Trust (2001).

[28] Mr. Smith testified that he and Mr. Scott accepted the plan and at that point in time they began to split income with family members. In other words, Mr. Smith and Mr. Scott, acting in concert as the only directors of the Operating Company, authorized the payment of dividends to the Holding Company for the benefit of Mr. Smith and to the Scott Family Trust for the benefit of Mr. Scott. In the words of Judge Dussault, Mr. Smith and Mr. Scott as the Operating Company's only directors and officers acted in concert and with a common economic interest to decide how they would withdraw the profits made by the Operating Company for their personal use.

[29] I do not accept the Appellant's argument that Mr. Scott was the decision maker with respect to the payment of dividends. This is not consistent with the evidence before me. Mr. Smith testified that both he and Mr. Scott accepted the plan to pay the dividends. The Operating Company then, except with regard to one week, paid the \$1,000 weekly amounts to the Holding Company pursuant to the agreement and direction of the two directors. There is no evidence before me that the Operating Company paid the dividends at the discretion of Mr. Scott.

[30] For the foregoing reasons, I find that the Holding Company and the Operating Company did not deal at arm's length with respect to the payment of the dividends by the Operating Company. Since this is the only issue raised by the Appellants regarding the application of section 160, the appeals are dismissed with costs to the Respondent.

Signed at Ottawa, Canada, this 30th day of April 2018.

"S. D'Arcy"

D'Arcy J.

CITATION: 2018 TCC 83

COURT FILE NOS.: 2016-2885(IT)G
2016-4104(IT)G
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STYLES OF CAUSE: HLB Smith Holdings Limited v. Her Majesty the Queen
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PLACE OF HEARING: Halifax, Nova Scotia

DATE OF HEARING: December 6, 2017

REASONS FOR JUDGMENT BY: The Honourable Justice Steven K. D'Arcy

DATE OF JUDGMENT: April 30, 2018

APPEARANCES:

Counsel for the Appellant: Brian K. Awad
Counsel for the Respondent: Stan W. McDonald

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