Docket: 2013-2493(IT)G

BETWEEN:

VAN LEE,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on May 30 and 31, 2018 and September 5 and 6, 2018,
at Vancouver, British Columbia

Before: The Honourable Justice John R. Owen

Appearances:

Counsel for the Appellant:	David Jacyk, Monica Biringer, David Wilson and David Ross
Counsel for the Respondent:	Michael Taylor

JUDGMENT

In accordance with the attached Reasons for Judgment, the appeal from the reassessments made under the *Income Tax Act* for the 2003, 2004 and 2005 taxation years, the notices of which are dated November 20, 2009, are allowed and the reassessments are vacated.

The Appellant shall have 30 days from the date of this Judgment to provide submissions as to costs and the Respondent shall have a further 30 days to respond to those submissions. Such submissions shall not exceed 10 pages for each party.

Signed at Ottawa, Canada, this 15th day of November 2018.

"J.R. Owen"

Owen J.

Citation: 2018 TCC 230
Date: 20181115
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VAN LEE,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Owen J.

I. Introduction

[1] This is an appeal by V. Paul Lee (the "Appellant") of the reassessment by the Minister of National Revenue (the "Minister") of his 2003, 2004 and 2005 taxation years (the "Taxation Years") by notices dated November 20, 2009 (the "Reassessments"). The Reassessments were confirmed on March 27, 2013.

[2] The Minister initially assessed the Appellant for the Taxation Years by notices dated June 14, 2004, August 29, 2005 and August 4, 2006, respectively. Accordingly, the Reassessments were issued after the expiration of the "normal reassessment period" for the Taxation Years as defined in subsection 152(3.1) of the *Income Tax Act*. This issue was not pleaded by either party.

[3] The Reassessments taxed the Appellant on the basis that a trust known as the Paul Lee Spouse Trust (the "Trust") that he settled did not exist either because the trust or the transfer of property to the trust was a sham, or because the trust was not properly constituted under Québec law.

[4] For its taxation year ending December 31, 2003, the Trust had taken filing positions in its Québec and federal income tax returns that allowed the Trust to obtain the benefit of a tax plan that was colloquially referred to as the Québec truffle. In brief, the Trust elected to be taxed federally on income it had distributed

to its beneficiary but did not elect to be taxed on this same income in Québec. Since the beneficiary of the Trust was not a resident of Québec, no provincial tax was paid on the distributed income. Nevertheless, the Trust received the federal abatement.

[5] The Province of Québec subsequently enacted retroactive tax legislation that deemed the Trust to have elected to be taxed on the distributed income in Québec, thereby retroactively eliminating the tax benefit associated with the Québec truffle strategy.

II. The Facts

[6] The parties filed a Joint Partial Agreed Statement of Facts (the "PASF") and a Joint Book of Documents (the "JBD"). The content of the PASF is as follows:[1]

> ***Background***
>
> 1. The appellant is an individual resident in Canada.
>
> 2. The appellant's spouse is Joyce Lee.
>
> 3. At all material times, the appellant and Mrs. Lee resided in British Columbia.
>
> 4. VPL Investments Inc. ("VPL") is a corporation formed under the laws of Canada by amalgamation on September 1, 1996.
>
> 5. VPL Ventures Inc. ("VCC") is a corporation formed under the laws of British Columbia on December 18, 1992.
>
> 6. Briel Investments Inc. ("Briel") is a corporation formed under the laws of British Columbia on August 27, 2003.
>
> 7. At all material times, VPL, VCC and Briel were Canadian-controlled private corporations for purposes of the *Income Tax Act*, RSC 1985, c 1 (5th Supp.) (the "Act").
>
> 8. Alain Paris is, and was at all material times, an individual who is a retired tax partner of KMPG LLP and a resident of Québec.
>
> 9. Prior to August 30, 2003, the appellant held 100% of the issued and outstanding common shares of VPL.

[1] The references in the PASF to Exhibits in the JBD have been amended to match the Exhibit number of the JBD.

10. Prior to August 30, 2003, the appellant held 80% of the issued and outstanding common shares of VCC, and Mrs. Lee held the other 20%.

11. Starting in July of 2002, the appellant sought advice from KPMG LLP.

12. In an engagement letter dated December 17, 2003, KPMG described the transactions it recommended as "Phase I" and "Phase II" of an estate plan. (**Exhibit AR-2, Tab 21**)

13. Phase I of the estate plan involved "freezing" the appellant and Mrs. Lee's interest in Briel and establishing a new discretionary family trust in to which the future growth of Briel would accrue (**Exhibit AR-2, Tab 21**).

14. Phase II of the estate plan involved gifting the majority of the appellant's interest in Briel to a spouse trust and subsequent redemption of those shares of Briel held by the spouse trust. Phase II was subject to what KPMG described as a "Success Based Billing arrangement", under which KPMG's fee was contingent and subject to reduction if a tax authority successfully challenged the transaction (**Exhibit AR-2, Tab 21**).

15. The transactions the parties entered into are described in a letter dated March 12, 2004 from KPMG to the appellant regarding "Estate Planning" (**Exhibit AR-2, Tab 24**).

2003 – The appellant implemented the Estate Plan

a. Incorporation of Briel and reorganization of shareholdings

16. On August 30, 2003, the appellant and Mrs. Lee transferred all of the shares of VPL and VCC that they held to Briel in exchange for the following shares of Briel:

	Type	Number	ACB	PUC
Appellant	Class C preferred	18,000	$1,947,315	$1,999,979
	Class D preferred	20,000	$52 686	$22
			$2,000,001	$2,000,001
Joyce	Class F preferred	2,000	$650,004	$20

17. The appellant and Mrs. Lee carried out the August 30, 2003 share transfers on a tax-deferred basis under section 85 of the Act. The appellant's 18,000 Class C preferred shares had an aggregate redemption value of $18,000,000.

b. The Establishment of the Paul Lee Spouse Trust (the "Trust") with the initial trust property

18. The Trust was created pursuant to a written notarial Trust Deed dated December 10, 2003. In the Trust Deed, the appellant appointed Mr. Paris as trustee of the Trust under the laws of Quebec (**Exhibit AR-2, Tab 4**).

19. Mrs. Lee was the sole beneficiary of the Trust during her lifetime.

20. The appellant wrote a cheque for $2,000 payable to the Paul Lee Spouse Trust dated December 8, 2003 (the "initial trust property") (**Exhibit AR-2, Tab 3**).

21. On December 11, 2003, Mr. Paris deposited the initial trust property in an account at the Bank of Nova Scotia (the "Scotiabank account") (**Exhibit AR-2, Tab 31**).

22. Mr. Paris accepted the initial trust property. He accepted his appointment as trustee.

23. The Scotiabank account was in the Trust's name.

24. The appellant transferred title to the initial trust property to Mr. Paris. Under the Scotiabank account agreement, only Mr. Paris had the legal power to write cheques or otherwise disburse or deploy funds (including the initial trust property) from the Scotiabank account.

25. Mr. Paris was not free to use the initial trust property for his own benefit. The trust deed did not direct Mr. Paris as to how to use the initial trust property other than in the best interests of the beneficiary. The appellant did not exercise direct or indirect control over the use, disbursement or deployment of the initial trust property after he transferred title to Mr. Paris, and no documents establish a mechanism by which the appellant controlled what Mr. Paris did with the initial trust property.

26. KPMG's plan did not direct Mr. Paris how to use the initial trust property or imply how Mr. Paris should use the initial trust property. KPMG's plan did not call for the appellant to retain control over the initial trust property (**Exhibit AR-2, Tab 24**). There are no facts of which the respondent is aware that support the assertion that the appellant controlled the initial trust property after he transferred title of that property to Mr. Paris.

27. None of the disbursements from the Scotiabank account went to the appellant.

28. The disbursements from the Scotiabank account were used to pay professional fees, including those of the trustee, and the payment of taxes for the Trust.

c. The transfer of preferred shares of Briel to the Trust and the redemption of the shares

29. Also on December 11, 2003, the appellant exchanged his 18,000 Class C preferred shares of Briel for 36,000 Class F redeemable preferred shares of Briel (**Exhibit AR-2, Tab 1**).

30. The 36,000 Class F shares received by the appellant had an aggregate redemption value of $18,000,000.

31. The appellant transferred the 36,000 Class F shares of Briel to the Trust on December 11, 2003. The appellant and Mr. Paris signed a Deed of Gift regarding the transfer (**Exhibit AR-2, Tab 8**). Mr. Paris signed a trust resolution resolving to accept the 36,000 Class F shares of Briel (**Exhibit AR-2, Tab 9**). The shares were registered in the name of "Alain Paris, Trustee of the Paul Lee Spouse Trust" (**Exhibit AR-2, Tab 1**).

32. The 36,000 Class F shares were not transferred to Mrs. Lee, and the December 11, 2003 transfer was not made for consideration.

33. On December 12, 2003, the Trust requested that Briel redeem the 36,000 Class F shares, and Briel redeemed the shares, for cash proceeds of $18,000,000. Mr. Paris signed a trust resolution to redeem the 36,000 Class F shares (**Exhibit AR-2, Tab 11**) and sent a request to the board of directors of Briel to redeem the shares (**Exhibit AR-2, Tab 12**). The directors of Briel (the appellant and Mrs. Lee) resolved to redeem the shares for total proceeds of $18,000,000 (**Exhibit AR-2, Tab 13**). Briel redeemed the shares and transferred $18,000,000 to the Trust's bank account in payment of the redemption proceeds (**Exhibit AR-2, Tab 31**).

d. The deemed dividend and capital gain from the share redemption

34. The paid up capital of the 36,000 Class F shares redeemed by Briel on December 12, 2003 was $1,999,979.

35. The redemption by Briel of the 36,000 Class F shares for proceeds of $18,000,000 resulted in a deemed dividend of $16,000,021, calculated as follows:

Redemption proceeds	$18,000,000
Less PUC	($1,999,979)
Deemed dividend	$16,000,021

36. The grossed-up amount of dividend income that is included in income under section 82 of the Act is $20,000,026.

37. The redemption by Briel of the 36,000 Class F shares for proceeds of $18,000,000 also resulted in a capital gain of $11,028 to the Trust.

e. The distribution and loan of the redemption proceeds

38. The same day (December 12, 2003), the Trust distributed $16,000,021 of dividend income to Mrs. Lee by way of a demand promissory note. Mr. Paris signed a trust resolution to distribute $16,000,021 to Mrs. Lee (**Exhibit AR-2, Tab 14**), and a promissory note payable to Mrs. Lee for $16,000,021. The note was payable on demand and was non-interest bearing up to the date of the demand, after which the outstanding principal bore interest at the rate of 6% per annum (**Exhibit AR-2, Tab 15**). Mrs. Lee signed a receipt for the note (**Exhibit AR-2, Tab 16**).

39. The same date (December 12, 2003), the Trust agreed to loan $18,000,000 to Briel at an interest rate of 4% per annum. Mr. Paris signed a trust resolution to loan $18,000,000 to Briel (**Exhibit AR-2, Tab 17**), and wrote a letter to the appellant offering to make the loan (**Exhibit AR-2, Tab 18**). Briel signed a promissory note for $18,000,000, bearing interest at 4% (**Exhibit AR-2, Tab 19**). Mr. Paris signed a receipt for the promissory note (**Exhibit AR-2, Tab 20**).

40. The Trust then transferred $18,000,000 from its bank account back to Briel to fund the loan (**Exhibit AR-2, Tab 31**).

f. Other facts pertaining to 2003

41. It was in the best interests of Mrs. Lee to establish the Trust, to transfer the shares to the Trust, to redeem the shares, and to distribute the redemption proceeds to Mrs. Lee. All of those transactions, as well as the loan back of the redemption proceeds to Briel, were outlined in the KPMG planning document (**Exhibit AR-2, Tab 24**).

42. On or about December 31, 2003, VPL assumed $9,900,000 of the $18,000,000 indebtedness owing by Briel to the Trust. The assignment agreement was prepared in or about November 2004 and was fully executed on or about December 23, 2004 (**Exhibit AR-2, Tabs 25, 26 and 27**).

2004 – The Trust accrues interest and receives part repayments of debt to pay its expenses

43. On February 23, 2004, VPL transferred $18,000 to the Trust to cover operating expenses of the Trust, which expenses were professional fees (**Exhibit AR-2, Tabs 22, 23, and 31**).

44. On March 25, 2004, Briel repaid $2,622,000 of its debt owing to the Trust. The Trust used those funds to pay its federal income tax owing of $2,617,185 for the 2003 taxation year on filing its 2003 T3 income tax return (**Exhibit AR-2, Tab 31**).

45. In December 2004, the Trust accrued interest of $269,329 on its loan to Briel and $396,000 on its loan to VPL for total interest income of $665,329 (**Exhibit AR-2, Tab 38**).

46. The Trust distributed income to the beneficiary on December 31, 2004, by issuing a demand promissory note in the amount of $665,329 to Mrs. Lee. Mrs. Lee signed a receipt acknowledging the note (**Exhibit AR-2, Tab 28**).

2005 – The Trust accrues interest and receives further part repayments of debt to pay its expenses

47. On March 23, 2005, VPL repaid $166,000 of its debt owing to the Trust. The Trust used those funds to pay its federal income tax owing of $160,315 for the 2004 taxation year on filing its 2004 T3 income tax return (**Exhibit AR-2, Tab 32**).

48. In December 2005, the Trust accrued interest of $229,149 from its loan to Briel and $406,710 from its loan to VPL for total interest income of $635,859 for the year ended December 31, 2005.

49. On December 31, 2005, the Trust distributed income to the beneficiary by issuing Mrs. Lee a demand promissory note in the amount of $635,859.

2006 and subsequent years

50. On March 28, 2006, VPL repaid $312,000 of its debt owing to the Trust. The Trust used those funds to pay its federal income tax owing of $153,332 for the 2005 taxation year on filing its 2005 T3 income tax return, and to pay Quebec provincial income tax of $148,607 on filing its 2005 Quebec income tax return (**Exhibit AR-2, Tab 33**).

51. On April 18, 2006, Alain Paris requested that Briel and VPL pay accrued but unpaid interest of $497,864 and $636,710, respectively, to the Trust (**Exhibit AR-2, Tab 29**).

52. On April 20, 2006 Briel and VPL paid $497,864 and $636,710, respectively, to the Trust. On April 24, 2006, Mr. Paris issued a receipt acknowledging those payments (**Exhibit AR-2, Tab 30**). Also on April 24, 2006, Mr. Paris wrote a cheque from the Trust for $1,134,574 (the total interest received from Briel and VPL) to the beneficiary, Mrs. Lee (**Exhibit AR-2, Tab 33**).

53. After 2005, up to the end of 2009, the Trust continued to report interest income and to distribute income to Mrs. Lee.

[7] In addition to the PASF, the Appellant, Alain Paris and David Lam were called to testify by the Appellant. Mr. Paris was the trustee of the Trust from

December 10, 2003 to December 12 or 13, 2008 and until he retired last year, Mr. Lam was a member of the aggressive tax planning section of the Vancouver Tax Services Office of the Canada Revenue Agency ("CRA").

[8] I found all of the witnesses to be credible. The following facts are drawn from their testimony.

[9] Mr. Paris has been a resident of Québec for almost all of his life and was with KPMG for 30 years between 1969 and 1999. For approximately one half of his tenure with KPMG, approximately 10% to 15% of Mr. Paris's practice included advising individuals regarding estate and financial planning matters and acting as a liquidator or trustee of estates. Mr. Paris estimated that he had acted as a trustee or liquidator approximately a dozen times between 1990 and 1999.

[10] In 1992, Mr. Paris was awarded the medal commemorating the 125th Anniversary of the Confederation of Canada by the Governor General of Canada. When he retired in 1999, Mr. Paris was head of KPMG's tax group in the Montreal office.

[11] After he retired from KPMG, Mr. Paris became an independent consultant focussing on strategy planning for small companies. Between 1999 and 2003, Mr. Paris remained a trustee of ten trusts that were established before he left KPMG.

[12] In the fall of 2003,[2] Mr. Paris was approached by Richard Frank, a tax manager with the Vancouver office of KPMG. Following that, Mr. Paris talked with two tax partners in the same office of KPMG about the then yet-to-be-established Trust. In an e-mail to Richele Frank, one of the tax partners, Mr. Paris stated that he "would be delighted to act as trustee for these New Quebec Trusts".[3] One of these trusts was the Trust.

[13] Mr. Paris engaged the services of Hugo Patenaude, a notary who was, at the time, with Fasken Martineau DuMoulin in Montréal and who Mr. Paris identified as an expert in the legal aspects of Québec trusts. Mr. Paris had engaged Mr. Patenaude in the past (including to draft ten trust deeds) and made the decision to engage him to perform the legal work in respect of the Trust. Mr. Paris described why he retained legal advisors as follows:

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[2] When asked to narrow down the date, Mr. Paris stated that it was likely November of 2003.
[3] Exhibit AR-2 at Tab 2 at page 10.

> I always retain Hugo and other people as well as legal advisor as I'm not from the legal side of the practice, the business practice, and I do -- I had a lot of confidence in Hugo in terms of his comments, recommendation, and his experience. Therefore, Hugo was retained by me to help me in the decision that had to be taken just to make sure that what I was doing was according to the trust agreement, what was contained in the trust in venture. And I was exchanging with Hugo regularly in the trust situation to make sure that I would be doing the things according to what was made -- what was planned to be done.[4]

[14] Mr. Paris knew the Trust was to be a resident of Québec and that none of the beneficiaries of the Trust would be residents of Québec. Mr. Paris had discussions with the Appellant prior to the execution of the Deed of Trust (the "Deed") establishing the Trust. Mr. Paris also visited the Appellant at his office in Vancouver but he could not recall whether that was before or after the Deed was signed. The Appellant testified that the meeting took place before the Deed was signed because he wanted to meet and vet Mr. Paris.

[15] Mr. Paris testified as to the nature of the conversations that he would have with the settlor before a trust was settled:

> Well, I always wanted to make clear that they understood the role that I was playing as a trustee, as being acting independently and being representing the -- being there to represent the [beneficiary] and take the beneficiary's interest at heart and making sure that it was all done to make sure that the beneficiary was always in the front of all of the decisions that were taken and that I would be the one that would take the decision. I would require the assistance of legal advisor or business advisor that I would retain if that was required. And that was all me and I didn't tolerate to have any interference from the settlor.[5]

[16] Mr. Paris testified that he did consider wishes of settlors but that he was never inclined to receive directions from settlors. Mr. Paris stated that he had resigned as a trustee on two or three occasions when the settlor asked him to change his investment policy.

[17] The Deed was prepared by Mr. Patenaude and was signed by Mr. Paris and the settlor on December 10, 2003 in front of Pierre Girard, who acted as the signing notary for the Trust under Québec law. Mr. Girard retained the original

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[4] Lines 24 to 28 of page 62 and lines 1 to 7 of page 63 of the transcript of the proceedings (the "Transcript").
[5] Lines 20 to 28 of page 67 and lines 1 to 4 of page 68 of the Transcript.

Deed and filed an original copy of the Deed under Québec law. Mr. Paris also retained an original copy of the Deed.[6]

[18] Mr. Paris reviewed the Deed before he signed the Deed. The beneficiaries of the Trust were Joyce Lee during her lifetime, and, upon her death, the children of Paul Lee (i.e., the Appellant) and Joyce Lee. Mr. Paris testified that this was consistent with his understanding of the Appellant's intentions as settlor of the Trust.

[19] The Appellant provided Mr. Paris with a cheque dated December 8, 2003 in the amount of $2,000, which Mr. Paris deposited in the bank account of the Trust in Montreal on December 11, 2003, the day after the Deed was signed. Mr. Paris opened the bank account for the Trust. Mr. Paris described this $2,000 cheque as the "initial gift to the Trust".[7]

[20] Mr. Paris testified that following the receipt of the $2,000 from the Appellant, he expected a further contribution by the Appellant of the shares of a private corporation called Briel Investment, a gift that had been discussed prior to the creation of the Trust.

[21] After reviewing articles 2.4 and 2.5 of the Deed, Mr. Paris described his understanding of his role vis-à-vis the property of the Trust and the non-reversionary nature of the Trust as follows:

> My understanding that I was in charge of the trust property, and that under my entire discretion and power, I would use that money or that patrimony for the benefit of the beneficiary, that was Joyce Lee. And it could be the capital, or the income of the trust.
>
> . . .
>
> . . . whatever was transferred by the settlor, became the property of the trust, and wasn't going to be returned to the settlor.[8]

[22] Mr. Paris testified that article 2.4 of the Deed was consistent with his understanding of the Appellant's intentions vis-à-vis the Trust.

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[6] Exhibit A-1. Mr. Paris explained that there was an "original, original" of the Deed and original copies of the Deed, all of which had the original signatures of the settlor, the trustee and the notary. Exhibit A-1 is Mr. Paris's original copy.

[7] Lines 8 and 9 of page 78 of the Transcript.

[8] Lines 1 to 6 of page 81 and lines 10 to 12 of page 82 of the Transcript.

[23] Mr. Paris further stated that the non-reversionary nature of the trust stipulated in Article 2.5 was also consistent with his understanding of the Appellant's intentions and that during his tenure as Trustee no property of the Trust reverted to the Appellant and no attempt was made to have property of the Trust revert to the Appellant.

[24] Articles 3.1.1 and 3.1.2 of the Deed state:

> Until the Material Date, the Trustee shall pay, to Joyce Lee all the Income derived from the Trust Property that arises before the Material Date.
>
> . . .
>
> Until the Material Date, the Trustee may pay or make payable all or part of the capital of the Trust Property, as the Trustee shall from time to time in his absolute, uncontrolled and unfettered discretion determined to or for the benefit of Joyce Lee.

[25] Mr. Paris testified that his understanding of these clauses was as follows:

> My understanding was that the income of the trust, on a yearly basis, was going to be attributed to Mme. Lee, and only to Mme. Lee.
>
> . . .
>
> I had the option to pay to Mme. Lee, the capital, or portion of the capital of the trust if I decided to do so, on my own judgment.[9]

[26] Mr. Paris also referred to Article 4 of the Deed, which he described as confirming Articles 2.5 and 3.1 of the Deed and providing the trustee with broad investment powers that were consistent with those conferred by the trust deeds of other trusts of which he was trustee.

[27] Mr. Paris testified that the transfer by the Appellant of 36,000 Class F preferred shares of Briel (the "Class F Shares") to the Trust was discussed before the Trust was established and that the transfer took place on December 11, 2003, which is the date of the deed of gift.[10]

[28] Counsel for the Appellant asked Mr. Paris about the redemption of the Class F Shares the next day on December 12, 2003:

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[9] Lines 8 to 10 and lines 24 to 26 of page 83 of the Transcript.
[10] Exhibit AR-2, Tab 8.

Q So, whose decision was it to redeem those shares?

A I decided to redeem the shares. It was offered to me to redeem the shares, I considered that, and I felt that it was very appropriate to do that.

Q Okay, did you discuss the potential of redeeming these shares in advance of signing the trust deed?

A It was discussed at the same time, yeah.

Q And who would you have discussed that with?

A I have discussed that probably with Paul Lee, and probably with Linda Richkum, and Rob Gear. Robert Gear.

Q Of KPMG?

A KPMG, yeah.

Q Okay. So, it's not as if this was a surprise of any sort?

A No, that wasn't a surprise.

Q So, something discussed in advance of entering the trust deed?

A Yeah, as an additional.

Q And I asked you whose decision was it, and you said that it was yours. So, let me ask you, why do you redeem the shares at this point?

A Well, I redeemed the shares because there was a substantial benefit by redeeming the shares. On upon the redemption, there was a deemed dividend of 16 million dollars, and a capital gain of approximately 11,000 taking place. And because that was done at the trust level, under the legislation that was in place at the time. There was a substantial saving of approximately 25 to 27 percent.

Q Okay, and what about -- these are shares in a company called Briel Investments Inc.

A Yeah.

Q And what was your understanding of Briel Investments Inc?

A That was a private company owned totally or partly, that I don't recall exactly by Paul.

Q Okay, so you knew that in advance?

A I knew that.

Q And we've looked at the different powers that you had. In your view, could you have made a decision not to redeem the shares?

A I could have, yeah, that was my decision. But as I said, I felt that it was quite appropriate, given the substantial savings that was attached to a transaction like that.

Q And what about the options? For example, did you feel -- would it have been an option to simply keep the shares?

A It would have been an option, but I don't think that it would have been very appropriate to sit on the share certificate there, and with -- I didn't know if there would be any dividends or anything of that nature on those shares. Before, by cashing that, I was receiving the cash of 18 million dollars, and realizing at the same time they got tax savings on their legislation that was in place in those years.

Q Did anyone ever tell you that you must redeem those shares?

A No, nobody told me that I must do things.

Q Did Mr. Lee ever tell you that?

A No, no, never did.[11]

[29] In cross-examination, Mr. Paris had the following exchanges with counsel for the Respondent regarding the redemption of the Class F Shares:

Q When you were asked to be a trustee for the Paul Lee Spouse Trust, everyone was very clear to you that they wanted you to take advantage of this [tax] opportunity, right?

A Yeah, it was obvious.

. . .

Q Now, you must've understood as well that when you were approached -- and it could've been Mr. Lee, or it could've been KPMG, or it could've been a combination of the two of them talking to you, you must have understood that in order to realize that tax benefit you would have to go

[11] Lines 3 to 28 of page 91, page 92 and lines 1 to 14 of page 93 of the Transcript.

through with their proposal that you redeem those shares that Mr. Lee would contribute to the trust and you get proceeds from Briel Investments?

A I was aware that we can -- we get proceed upon redemption of the shares, yeah, sure.

Q Doesn't -- from a tax perspective it doesn't do you any good to receive those shares and just hold them, right?

A No.

Q There's no income to generate tax that can be saved. You're not taking advantage of that opportunity.

A Yeah

. . .

Q Yes, I understand that, but I'm just saying, put yourself back in your shoes as trustee on December 11th, 2003. Mr. Lee gifts $18 million worth of redeemable shares to the trust.

A Yeah.

Q Until you redeem those shares, there is no way to access the tax saving from that strategy?

A No, there wasn't.

Q So, if you held the shares into 2004, there is no 2003 tax, there is nothing to save, right?

A Yeah, right.

Q But there is also no loan, there is no interest in that year either, until you actually do these things, these transactions?

A Sure, mm-hmm.

Q And what I am suggesting to you is, once you became, once you agreed to become trustee of this trust, and to accept those shares, it really made no sense, there is no good reason not to redeem those shares immediately and receive the proceeds, is there?

A That is your opinion, yeah.

Q Well, what was your opinion? You redeemed them the very next day.

A I did look at the situation, and I felt that it was very appropriate to redeem them, therefore I decided to redeem them.

Q And why was it appropriate?

A Well, it was appropriate because that puts $18 million worth of cash that could be lend back to Briel and earn four percent more of interest, which would amount to approximately $600,000 worth of income a year. And I felt that was quite appropriate to do that in order to create the patrimony for Mme. Lee, the beneficiary of the trust.

Q So, you thought that was better for her, than leaving the value in those shares without redeeming them?

A That was my opinion.

Q Also, obviously, it put that $16 million worth of income, which was distributed to her, into her hands, through a promissory note.

A Yeah.

Q With no provincial tax.

A You are right.[12]

[30] Counsel for the Appellant asked Mr. Paris about the loan by the Trust to Briel in the amount of $18 million:

Q Okay, and can you just tell me what it is?

A I did prepare that. It was further to a request by Mr. Lee, I did accept to loan Briel Investment an amount of money of 18 million dollars.

Q And so you mentioned that you prepared this document?

A I did prepare the document.

Q And it says, "payable on demand."

A Yes, that was a demand loan.

[12] Lines 11 to 15 of page 145, lines 17 to 28 of page 146, lines 1 to 7 of page 147, lines 8 to 28 of page 148 and lines 1 to 25 of page 149 of the Transcript.

Q And it says, “interest at the rate of 4 percent.”

A It was interest at 4 percent.

Q And how did that accumulate, the 4 percent?

A The compounded interest accumulated on a compound basis, therefore it means if the interest is not paid it’s added to the capital and new interest is -- the following year the interest is computed on the capital plus the interest, the accrued interest.

Q Okay, and who came up with these terms? Who decided on these terms?

A After consulting different sources, I felt that it was appropriate to lend the money at that rate of interest.

Q Why?

A The choices were that I could use an investment manager to take the money. There would have been fees that I would have to pay, and therefore here I didn’t have any fee to pay and I was confident that the $18 million could be redeemed easily.

Q Okay, and why is that? What if anything did you know about Briel Investments?

A When I consulted what was in Briel I did realize that Briel and the company associated with that had substantial amount of investment at fair market value were substantial, way above the $18 million.

Q Now, would you have discussed with anyone the possibility of this loan in advance of signing the trustee?

A That was discussed at the same time when we put the trust in place.

Q So, again, this is not a surprise.

A No, it is not a surprise. The request was made that I can make a loan and I discussed that if it was an appropriate and I discussed that with Hugo Patenaude, the legal advisor, and I came to the conclusion that I can do that.

Q So whose decision was this, Mr. Paris?

A That was my decision.

Q And did anyone ever tell you that you must loan these monies back to Briel?

A Never -- nobody never told me that I must do those things.

Q And let me ask you, had you come to the conclusion that if it wasn't in the interest of the beneficiaries, would have entered into that loan?

A No, I would not have.

Q Did you have some other form of agreement, that for example required you to redeem the Briel shares?

A No.

Q And can I ask you what if you had been told that you must do this?

A I do not recall receiving any directions or must things to do in regard to any of those related transactions or surrounding transactions. That was my decision, it was offered to me to do those things. I looked at the options and I felt that it was the best thing I can do in the circumstances.[13]

[31] Mr. Paris explained in examination-in-chief that the deemed dividend received on the redemption of the Class F Shares was income to the Trust and therefore under the terms of the Deed had to be paid to Mrs. Lee as the sole beneficiary of the Trust during her lifetime. The income was paid by the Trust to Mrs. Lee by issuing a demand promissory note in the amount of $16,000,021 (the "Demand Note").[14] The Demand Note was non-interest bearing until demand, after which it bore interest at 6% per annum. Mr. Paris stated that he did not receive a demand from Mrs. Lee to repay the Demand Note. Mr. Paris was asked what he would do if there was a demand to pay the Demand Note:

Q Okay, but had you considered what you might have done if the beneficiary makes the demand?

A If the demand had been exercised, I would have request repayment from the Briel Investment on my demand note and received the money quickly and pay Mme. Lee at that time.

Q I want you to turn to – you mentioned earlier that again, I think, I think I'm being accurate, that this was something that would have been discussed in advanced of entering the trust?

[13] Lines 24 to 28 of page 93, pages 94 and 95 and lines 1 to 11 of page 96 of the Transcript.
[14] Exhibit AR-2, Tab 15.

A Yes.[15]

[32] In April 2006, Mr. Paris sent an e-mail to the Appellant reminding him that Briel and VPL owed the Trust interest that had accrued during 2005 in the amount of $497,864 and $636,710, respectively. Mr. Paris stated that the outstanding interest was paid by cheques within two days.[16]

[33] Mr. Paris created and maintained running summaries of the payments in and out of the Trust's bank account and of the interest accruing on the debts owed by Briel and VPL.[17]

[34] In cross-examination, counsel for the Respondent and Mr. Paris had the following exchange regarding the steps outlined in Exhibit AR-2, Tab 24:

> Q And I'm going to suggest to you that, you know, I will never know what you discussed with Mr. Lee or KPMG before you agreed to be trustee, but I'm going to suggest to you that all of those details were known to you before you became trustee. You know what was going to happen. You were -- you knew you were going to implement those transactions as they were proposed to you, as they had been planned. Would you agree with that?
>
> A Well, I mean what I did, what you see here is the document that was prepared from what I see on March 12th, 2004. And at that point all of the resolution that you're referring to had been prepared by my legal counsel in December 2003. Therefore, it seems to me that what you have here is a recap of what I did on my own with the help of my legal counsel. And what they're saying is what happened. Therefore I was contacted at the end of November 2003, to do a transaction. That is exactly what happened. And I confirmed that it all happened like that, but I was involved in each step of the transaction without seeing that. And here what I can see, and with all due respect, the document here is dated March 12, 2004 three months after the transaction happened. Therefore, all of those resolutions were available to anybody that was close to Paul Lee or KPMG. And the resolutions were prepared by Fasken Martineau DuMoulin in Montreal, that was retained as my legal counsel, before I question all of those steps, all along the way. And that's what I did.
>
> Therefore, it was my decision and the loan agreement was negotiated by me, I had an offer to loan the money back, which I did. And I confirmed all of that. It was all done. But this document here I didn't have that

[15] Lines 7 to 17 of page 99 of the Transcript.
[16] Exhibit AR-2, Tab 33 at page 150.
[17] Exhibits AR-2, Tab 34, and A-3.

> document and I didn't know anything about that except what I did was backed by resolution documented paper, documenting all the work.[18]

[35] With respect to the timing of his decisions regarding the actions of the Trust on December 10, 11 and 12, 2003, Mr. Paris testified as follows in cross-examination:

> A Yeah, I mean you're right. The decision was taken on the 10, 11 or 12 but it was proposed before. Therefore I have time to think about it, maybe not take a decision at that time but the process of thinking was there and the reflection and the call for doing whatever has to be done for doing whatever has to be done could have been done on the 10 or the 11 or the 12. But the proposal -- it was clear what was the position. You came across that and I confirmed that it was, that's the way it was done. But it doesn't mean that the decision was taken before I became trustee.
>
> I became trustee and at that point I did look at it once again and I said, "Well, it makes sense to do that.' Obviously I had seen what was involved in that and I knew what were the consequences of doing that and I knew that it could be done in accordance with the law that was in force at the time.[19]

[36] The Appellant testified that he began to contemplate the establishment of a trust in 2002 and sought advice from KPMG. Initially, he considered only a family trust but that evolved into a spouse trust and a family trust. The Appellant explained that the spouse trust would allow him to transfer wealth to his wife and the family trust would allow him to transfer future growth to his two children, who were born in 1999 and 2000. The Appellant described the reasons for using trusts as estate planning and liability protection.

[37] The Appellant told KPMG that he was looking for a trustee who had a strong reputation, was conservative when it came to investments and was an expert in trusts. Approximately three months later, KPMG recommended Mr. Paris. The Appellant understood that there were tax benefits to having a trustee resident in Québec.

[38] The Appellant testified that he met with Mr. Paris in his office in Vancouver in October or November 2003. The Appellant stated that he insisted on meeting Mr. Paris and that the meeting had two purposes:

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[18] Lines 24 to 28 of page 169, page 170 and lines 1 to 4 of page 171 of the Transcript.
[19] Lines 13 to 28 of page 173 and lines 1 to 2 of page 174 of the Transcript.

> A Well, there was two parts. I wanted to know who he was. I wanted to see if he met the criteria. As we got closer, it was also clear that he hadn't accepted yet. So then I wanted to also convince him that he should take this on.[20]

[39] The Appellant described the content and result of the meeting in the following exchange with his counsel:

> Q Okay. And do you recall what you would've discussed at that meeting?
>
> A Yeah, we talked about his background, how long and that he was retired now and that he was a professional trustee. I talked about my background, about Electronic Arts a lot. He asked me a lot of questions about Electronic Arts. And then I talked a lot about my investment background. I wanted to give him some comfort and understanding that the money was legitimate and that I was a) a stable person. I was -- I knew what I was doing and -- I was trying to convince him to be the trustee. I remember I was going in saying, 'I gotta somehow convince him to take this on.'
>
> Q After meeting with Mr. Paris, did you draw any conclusions of whether he would meet your expected requirements?
>
> A Yeah, I thought he was perfect.[21]

[40] The Appellant's counsel took the Appellant to articles 2.2, 2.3, 2.4, 2.5, 3.1.1, 3.1.2 and 4 of the Deed and asked him for his understanding of the provisions and whether the provisions were consistent with his intentions. The Appellant described the purpose of each of the provisions and in each case stated that that purpose was consistent with his intentions. The Appellant stated that he was advised probably in every meeting of the irrevocability of the gifts to the Trust and that it was his intention to make such gifts to the Trust. He also understood that the trustee of the Trust had full authority over the property of the Trust and the discretion to invest in almost anything.

[41] The Appellant testified that he donated $2,000 and the Class F Shares to the Trust and that but for the financial crisis in 2008 he may have made further contributions. The Appellant stated that after the gift of the Class F Shares to the Trust he did not expect to control those shares. He also stated that he did not try to compel Mr. Paris to redeem the Class F Shares, that he did not have any agreement with Mr. Paris that required Mr. Paris to redeem the shares or loan the proceeds of

[20] Lines 21 to 25 of page 259 of the Transcript.
[21] Lines 2 to 19 of page 261 of the Transcript.

redemption to Briel and that he did not expect to control the proceeds received by the Trust on the redemption of the shares.

[42] Mr. Lam led the audit of the Paul Lee Spousal Trust. Mr. Lam was subject to cross-examination by counsel for the Appellant under subsection 146(3) of the *Tax Court of Canada Rules (General Procedure)* (the "Rules").

[43] Mr. Lam testified that the Trust was audited as part of a program that reviewed approximately 200 files. Mr. Lam did not interview the Appellant or Mr. Paris before reassessing the Appellant. Mr. Lam stated that Mr. Paris was interviewed by a CRA auditor based in Québec but that he did not read the transcript of that interview.

[44] Mr. Lam was cross-examined extensively on the audit and the assumptions of fact in the Amended Reply but none of his testimony is relevant to the issues in this appeal.

A. Position of the Appellant

[45] The Appellant submits that the Trust was validly constituted under Québec law and that neither the Trust nor the initial transfers of property to the Trust constituted shams. Accordingly, the income tax liability of the Trust cannot be attributed to the Appellant.

B. Position of the Respondent

[46] The Respondent submits that either the Trust or the initial transfers of property to the Trust constituted a sham. In the alternative, the Respondent submits that the Trust was not validly constituted under Québec law and should be disregarded. Under either theory, the Respondent submits that the income tax liability of the Trust for the Taxation Years becomes the income tax liability of the Appellant as settlor of the Trust.

[47] The Respondent stated at the opening of the hearing that if the Respondent is successful in this appeal, the federal income tax already paid by the Trust will be credited by the CRA to the Appellant.

III. Analysis

A. Is there a Sham?

[48] *Snook v. London & West Riding Investments, Ltd.*, [1967] 1 All E.R. 518 ("*Snook*") is the source of the modern doctrine of sham. In that case, Diplock L.J. states:

> As regards the contention of the plaintiff that the transactions between himself, Auto-Finance, Ltd. and the defendants were a "sham", it is, I think, necessary to consider what, if any, legal concept is involved in the use of this popular and pejorative word. I apprehend that, if it has any meaning in law, **it means acts done or documents executed by the parties to the "sham" which are intended by them to give to third parties or to the court the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intend to create**. One thing I think, however, is clear in legal principle, morality and the authorities . . . that for acts or documents to be a "sham", with whatever legal consequences follow from this, **all the parties thereto must have a common intention** that the acts or documents are not to create the legal rights and obligations which they give the appearance of creating. No unexpressed intentions of a "shammer" affect the rights of a party whom he deceived. . . . [22]
>
> [Emphasis added.]

[49] In *Stubart Investments Ltd. v. The Queen*, [1984] 1 S.C.R. 536 ("*Stubart*"), Estey J. stated:

> . . . A sham transaction: This expression comes to us from decisions in the United Kingdom, and it has been generally taken to mean (but not without ambiguity) **a transaction conducted with an element of deceit** so as to create an illusion calculated to lead the tax collector away from the taxpayer or the true nature of the transaction; or, simple deception whereby the taxpayer creates a facade of reality quite different from the disguised reality. . . . [23]
>
> [Emphasis added.]

[50] In concurring reasons, Wilson J. states:

> As I understand it, a sham transaction as applied in Canadian tax cases is one **that does not have the legal consequences that it purports on its face to have**. . . . [24]
>
> [Emphasis added.]

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[22] At page 528. The Supreme Court of Canada adopted this description of sham in *M.N.R. v. Cameron*, [1974] S.C.R. 1062 at page 1068. *Snook* is still cited in United Kingdom jurisprudence for the meaning of sham. See, for example, the recent decision of the United Kingdom Supreme Court in *UBS AG v. Commissioners for Her Majesty's Revenue and Customs; DB Group Services (UK) Ltd v. Commissioners for Her Majesty's Revenue and Customs*, [2016] UKSC 13 at paragraph 38 ("*UBS*"). The comment in *UBS* is brief but highlights that an important element of sham is the intention to deceive.

[23] At page 545.

[24] At page 539.

[51] In *Continental Bank Leasing Corp. v. Canada*, [1998] 2 S.C.R. 298 ("*Continental Bank*"), the Supreme Court of Canada interpreted Estey J.'s comments in *Stubart* to mean that the "sham doctrine will not be applied unless there is an element of deceit in the way a transaction was either constructed or conducted."[25]

[52] The Court in *Continental Bank* held that the determination of whether a sham exists precedes and is distinct from the correct legal characterization of a transaction. If the transaction is a sham, the true nature of the transaction must be determined from extrinsic evidence (i.e., evidence other than the document(s) papering the transaction). If the transaction is not a sham, the correct legal characterization of the transaction can be determined with reference to the document(s) papering the transaction.[26]

[53] In *Faraggi v. The Queen*, 2008 FCA 398, Noɹl J.A. (as he then was) stated:

> The concepts of "sham" and "abuse" are not the same. I do not believe that the few words of Iacobucci J. in *Antosko, supra*, cited by the TCC judge (Reasons, para. 87, note 34), were intended to alter this view. Nowhere in the extensive case law dealing with the concept of "sham" is it suggested that "sham" and "abuse" are analogous. Iacobucci J.'s brief comment, which was part of a discussion on the principles of statutory interpretation, cannot be read as bringing about such a radical change.
>
> Subject to the invocation of the [general anti-avoidance rule] in a particular case, taxpayers are entitled to arrange their affairs in such a way as to minimize their tax burden, even if in doing so, they resort to elaborate plans that give rise to results which Parliament did not anticipate. . . .
>
> However, courts have always felt authorized to intervene when confronted with what can properly be labelled as a sham. . . .[27]

[54] After reviewing several judgments addressing sham, Noɹl J.A. concludes:

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[25] At paragraph 20. This paragraph is in the dissenting reasons of Bastarache J. However, at paragraph 103 of the reasons for judgment, McLachlin J. (as she then was), writing for the majority, agrees with all aspects of Bastarache J.'s dissenting judgment other than his conclusion that the partnership was void under the *Partnerships Act*, R.S.O. 1980, c. 370.

[26] *Ibid*., at paragraph 21, where Bastarache J. adopts an excerpt from the judgment of the English Court of Appeal in *Orion Finance Ltd. v. Crown Financial Management Ltd.*, [1996] 2 B.C.L.C. 78. The correct legal characterization of a transaction is sometimes referred to as the "legal substance" of the transaction as opposed to the "legal form" of the transaction (see, generally, Nik Diksic, "Some Reflections on the Roles of Legal and Economic Substance in Tax Law," Report of Proceedings of Sixty-Second Tax Conference, 2010 Conference Report (Toronto: Canadian Tax Foundation, 2011), 25:1-34.

[27] Paragraphs 55 to 57. Leave to appeal to the Supreme Court of Canada refused on April 24, 2009.

> It follows from the above definitions that the existence of a sham under Canadian law requires an element of deceit which generally manifests itself by a misrepresentation by the parties of the actual transaction taking place between them. When confronted with this situation, courts will consider the real transaction and disregard the one that was represented as being the real one.[28]

[55] In *Antle v. The Queen*, 2009 TCC 465 ("*Antle*"), Miller J. considered whether a Barbados trust was validly constituted and whether it was a sham. In the course of his decision, Miller J. summarized the circumstances surrounding the purported creation of the trust as follows:

> Notwithstanding the Trust Deed was dated December 5th, I find Mr. Antle did not sign the Deed until December 14th and only then could the Trust have been created. Recall that on December 12th, Mr. Antle was contacting Mr. Brown suggesting that the Trust must be finalized. Mr. Antle and Mr. Truss never communicated on or before December 14th, so December 14th would be the first time both settlor and trustee saw their respective signatures on the Trust Deed. What were the circumstances then on December 14th that might shine a light on Mr. Antle's true intentions?
>
> - Mr. Truss had already signed a Bill of Sale on December 13th transferring the shares on to Mrs. Antle;
>
> - Mr. Truss had already signed on December 13th a Capital Property Distribution and a Direction to Pay;
>
> - Mr. Antle's request that funds be handled only through his lawyer's trust account was acceded to;
>
> - Mr. Antle had inquired into the need for share certificates to go to Barbados and told it was unnecessary;
>
> - Mr. Antle had agreed to the additional consideration for Stratos under duress, maintaining his right to sue Stratos personally for $1.38 million;
>
> - It was not Mr. Truss' idea to sell the property to the beneficiary and distribute the proceeds back to her;
>
> - Mr. Antle understood Mr. Truss would follow through with all steps of the strategy as they were all in the best interests of the beneficiary; there was no reason (commercial, economic, fiduciary or otherwise) to do anything other than what the strategy stipulated, effectively stripping him of discretion;

[28] Paragraph 59.

> - Mr. Antle understood all steps in the strategy had to be completed for a successful avoidance result;
>
> - Mr. Antle was aware that MI had been concerned about the need for Stratos' consent on release, which was in hand, removing any impediment to the closing of the sale: the Trust was never mentioned as an impediment;
>
> - Mr. Antle had never spoken to Mr. Truss; and
>
> - Nothing in the body of the Trust Deed itself operates to settle the shares in the Trust.
>
> Under these circumstances, on December 14th Mr. Antle signed a Trust Deed dated December 5th claiming, in the preamble, to have transferred the shares. This is not illustrative of an intention to settle a trust. If Mr. Antle intended any role for Mr. Truss, it may at best have been as agent in a gift from him to his wife.[29]

[56] Miller J. concluded that the trust in *Antle* was not validly constituted but declined to find that the trust was a sham. On appeal, Noɹl J.A. reviewed the question of whether the trust was a sham, stating:

> The Tax Court judge found as a fact that both the appellant and the trustee **knew with absolute certainty** that the latter had no discretion or control over the shares. Yet both signed a document saying the opposite. The Tax Court judge nevertheless held that they did not have the requisite intention to deceive.
>
> In so holding, the Tax Court judge misconstrued the notion of intentional deception in the context of a sham. The required intent or state of mind is not equivalent to *mens rea* and need not go so far as to give rise to what is known at common law as the tort of deceit (compare *MacKinnon v. Regent Trust Company Limited*, (2005), J.L. Rev. 198 (CA) at para. 20). **It suffices that parties to a transaction present it as being different from what they know it to be.** That is precisely what the Tax Court judge found.
>
> When regard is had to the reasons as a whole, it is apparent that the only reason why the Tax Court judge reached the conclusion that he did is his finding that the appellant and the trustee - as well as all participants in the plan - could say "with some legitimacy" that they believed that the trustee had discretion over the shares (Reasons, para. 71). While the claim to "some legitimacy" may show that there was no criminal intent to deceive (as would be required in a prosecution pursuant to subsection 239(1) of the Act) and perhaps no tortious deceit, it does not detract from the Tax Court judge's finding that **both the appellant and the trustee gave**

[29] Paragraphs 47 and 48.

> **a false impression of the rights and obligations created between them**. Nothing more was required in order to hold that the Trust was a sham.
>
> I respectfully conclude that the Tax Court judge was bound to hold that the Trust was a sham based on the findings that he made.[30]
>
> [Emphasis added.]

[57] Noɹl J.A.'s finding of sham in *Antle* turns on the finding of fact by the trial judge that the parties "knew with absolute certainty that the trustee would not say no" and that "both the appellant and the trustee gave a false impression of the rights and obligations created between them". Noɹl J.A. implicitly concluded that absolute certainty that the trustee would act in a certain fashion was inconsistent with the representation in the trust deed that the trustee had discretion to act as he saw fit. This inconsistency led inexorably to the conclusion that the settlor and the trustee did not intend the trustee to have any discretion but nevertheless entered into a trust deed that stated that the trustee did have discretion. The factual misrepresentation of the actual legal rights constituted the sham.[31]

[58] Noɹl J.A. cites *MacKinnon v. Regent Trust Company Limited*, 2005 JLR 198 (CA) at paragraph 21, where the Jersey Court of Appeal explains what must be established under Jersey law to find a sham in the context of a settlement:

> In my judgment the position in Jersey law is clear. In order to succeed in showing that the three settlements are shams, Andrew must establish that—
>
> (i) both Mrs. MacKinnon and Salamis intended that the true position would not be as set out in the settlement deeds, but that either the settlements were invalid and of no effect, or that the assets of the settlements were held for Mrs. MacKinnon absolutely, so that the assets were simply held to her order; and
>
> (ii) both Mrs. MacKinnon and Salamis intended to give a false impression to a third party or parties (including the other beneficiaries and the courts) that the assets had been donated into the settlements and were held on the terms of the deeds.

[59] It can be seen from the foregoing authorities that a transaction is a sham when the parties to the transaction present the legal rights and obligations of the parties to the transaction in a manner that does not reflect the legal rights and obligations, if any, that the parties intend to create. To be a sham, the factual presentation of the legal rights and obligations of the parties to the sham must be

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[30] 2010 FCA 280, at paragraphs 19 to 22. Leave to appeal to the Supreme Court of Canada was refused.

[31] I note that other facts such as the apparent back-dating of the trust deed may have contributed to this conclusion.

different from what the parties know those legal rights and obligations, if any, to be. The deceit is the factual representation of the existence of legal rights when the parties know those legal rights either do not exist or are different from the representation thereof.

[60] The Respondent submits that the circumstances in this appeal are indistinguishable from the circumstances in *Antle*. I disagree. One only has to read Miller J.'s findings of fact to conclude that the two cases have little in common other than the existence of a tax plan.

[61] In *Antle*, Miller J. found that the trust deed was originally signed by Mr. Truss (the trustee) on October 27, that the date on the front page was subsequently changed to December 5 and that Mr. Antle signed the trust deed on December 14. Even before the trust deed was signed, Mr. Truss had signed a bill of sale transferring the shares settled on the trust to the beneficiary of the trust, Mrs. Antle, as well as a capital property distribution and direction to pay. All funds were handled through a lawyer's trust account, so no funds came into the possession of the trust. Nothing in the body of the trust deed addressed the settlement of shares on the trust. Mr. Truss was recently admitted to the bar and had to do research to understand the duty of a trustee. Mr. Antle never met or communicated with Mr. Truss.

[62] In this case, the Appellant provided Mr. Paris with a cheque for $2,000 dated December 8, 2003 to settle the Trust and the Deed evidencing the Trust was executed by the settlor and the trustee in front of a Québec notary on its face date of December 10, 2003. On December 11, 2003, Mr. Paris deposited the cheque in a bank account he opened for the Trust and over which he had exclusive signing authority and the Appellant transferred the Class F Shares to the Trust. Mr. Paris signed a resolution of the Trust dated December 11, 2003 accepting the Class F Shares. Mr. Paris was an experienced trustee and retained the services of expert advisors to assist with the creation of the Trust and the transactions that followed. The Appellant and Mr. Paris communicated and met prior to the creation of the Trust.

[63] In *Antle*, Miller J. found that "Mr. Antle understood Mr. Truss would follow through with all steps of the strategy as they were all in the best interests of the beneficiary; there was no reason (commercial, economic, fiduciary or otherwise) to do anything other than what the strategy stipulated, effectively stripping him of discretion". This was a finding of fact by Miller J. based on the evidence before him in that appeal. I decline to make a similar finding of fact in this appeal.

[64] A three-person panel of the Jersey Royal Court provides some illuminating commentary regarding the meaning of discretion in *Re Esteem Settlement*, 2003 JLR 188, at paragraph 167:

> 167 On numerous occasions during the course of the hearing, Mr. Journeaux was driven to repeat that Abacus had not rejected any request of Sheikh Fahad. A lack of any refusal may of course be indicative of the fact that trustees have abdicated their fiduciary duties and are simply following the wishes of the settlor without further consideration. But, as mentioned above, a lack of any refusal may be equally consistent with a properly administered trust where the trustees have in good faith considered each request of the settlor, concluded that it is reasonable and concluded that it is proper to accede to such requests in the interests of one or more of the beneficiaries of the trust. But one does not start, as at times seems to have been the plaintiffs' case, with an attitude that it is very surprising and worthy of criticism that the trustee acceded to all Sheikh Fahad's requests. On the contrary, as the Privy Council said in Letterstedt (26), trustees exist for the benefit of beneficiaries and it is in our judgment very common that trustees will have perfectly properly acceded to all the requests of a settlor without in any way abdicating their fiduciary duties and responsibilities. Our task is to ascertain what the true facts were in this case.

[65] Mr. Paris testified that he was aware prior to the creation of the Trust of the various steps required to implement the Québec truffle and stated that that simply gave him more time to consider whether the strategy was in the best interests of the beneficiary of the Trust (i.e., Mrs. Lee). Mr. Paris was adamant that once the Trust was established, he made the decisions necessary to carry out the steps required to implement the Québec truffle and that he was not required or compelled to make those decisions. The Deed gave Mr. Paris exclusive authority over the corpus of the Trust and Mr. Paris chose to exercise that authority in his capacity as trustee in a manner that implemented KPMG's tax plan, a strategy, which he believed was in the best interests of the beneficiary of the Trust.

[66] The Appellant understood that there was a tax strategy for the Trust, but he did not focus on the details of that strategy. The Appellant testified that the terms of the Deed accurately reflected his intentions relating to the Trust. The Appellant understood he was irrevocably transferring property to the Trust for the benefit of Mrs. Lee and that following the transfer of that property he had no control over that property or any property substituted for that property. The Appellant clearly relied on KPMG regarding the details of the tax plan and as a result he did not have the knowledge of the tax plan that would be needed to direct Mr. Paris how to carry out the plan.

[67] In my view, the fact that Mr. Paris followed a course of action recommended by KPMG that he concluded after proper deliberation was in the best interests of the beneficiary of the Trust is perfectly in keeping with the role of a trustee of a discretionary trust. While the reasonable expectation of all concerned may have been that Mr. Paris would follow the steps suggested by KPMG, that expectation is not evidence of an absence of discretion, nor is it evidence of a sham. Under the terms of the Deed, Mr. Paris had the legal authority to make all necessary decisions regarding the Trust and its property and he in fact made those decisions. A decision to follow a pre-conceived or pre-planned course of action is still a decision. Mr. Paris had the expertise and experience to consider the best interests of the beneficiary and to make that decision.

[68] The Respondent appears to be applying the concept of sham as a sort of step transaction doctrine to disregard the creation of the Trust. That is neither correct nor appropriate. A sham involves an element of deceit—the parties must intend to give to third parties the appearance of creating between them legal rights and obligations different from the legal rights and obligations, if any, that the parties actually intend to create. An allegation of sham is an allegation that the parties to the alleged sham have been deceitful because they know that the actual legal rights and obligations created by them, if any, differ from the legal rights and obligations presented to the outside world.

[69] Creating legal (or equitable) relationships to give effect to a tax plan is not the perpetration of a sham. In this case, there was no deceit on the part of the Appellant or Mr. Paris regarding the legal relationships created under Québec law. The Deed and other relevant documentation reflect precisely the legal rights and obligations intended by the parties to those documents. Indeed, the tax plan would not work if just one of the steps necessary to implement that plan was not legally effective.

[70] The Respondent cross-examined the Appellant extensively regarding his reasons for establishing the Trust. The Appellant repeatedly stated that he wanted to provide for his spouse. However, even if the Appellant's sole reason (motive) for creating the Trust and transferring the Class F Shares to the Trust was to save tax, that is not in and of itself evidence of a sham. In order to achieve the tax objectives of the Québec truffle, the Appellant had to create a trust with certain legal qualities (e.g., irrevocable, for the benefit of his spouse during her lifetime, resident in Québec, etc.). The Deed and the other documentation did precisely that. The Appellant was fully apprised of the legal ramifications of what he was doing and he accepted those legal ramifications.

[71] *Stubart* is a prime example of a case in which the taxpayer entered into legal relationships solely to save tax. The Supreme Court of Canada's decision in *Stubart* makes clear that the question raised by an allegation of sham is not why or how the legal relationships were created but whether the parties factually misrepresented the legal relationships in the documents that describe those relationships. On this point, the following comments of the Court in *Stubart* are instructive:

> With respect to the courts below, it seems to me that there may have been an unwitting confusion between the incomplete transaction test and the sham test. Earlier I have enumerated the many public registrations effected by the parties in the course of this transaction. The documents establishing and executing the arrangement between the parties were all in the records of the parties available for examination by the authorities. There has been no suggestion of backdating or buttressing the documentation after the event. T**he transaction and the form in which it was cast by the parties and their legal and accounting advisers cannot be said to have been so constructed as to create a false impression in the eyes of a third party, specifically the taxing authority. The appearance created by the documentation is precisely the reality. Obligations created in the documents were legal obligations in the sense that they were fully enforceable at law.** The courts have thus far not extended the concept of sham to a transaction otherwise valid but entered into between parties not at arm's length. . . .[32]
>
> [Emphasis added]

[72] In *Neuman v. M.N.R.*, [1998] 1 S.C.R. 770, the Supreme Court of Canada provided the following additional comments regarding non-arm's length transactions:

> Finally, the requirement of a legitimate contribution [to a corporation] is in some ways an attempt to invite a review of the transactions in issue in accordance with the doctrines of sham or artificiality. Implicit in the distinction between non-arm's length and arm's length transactions is the assumption that non-arm's length transactions lend themselves to the creation of corporate structures which exist for the sole purpose of avoiding tax and therefore should be caught by s. 56(2). However, as mentioned above, taxpayers are entitled to arrange their affairs for the sole purpose of achieving a favourable position regarding taxation and no distinction is to be made in the application of this principle between arm's length and non-arm's length transactions (see *Stubart*, *supra*). . . .[33]

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[32] At pages 572 - 573.

[33] Paragraph 63. See, also, the recent comments of the majority at paragraph 41 of *Jean Coutu Group (PJC) Inc. v. Canada (Attorney General)*, 2016 SCC 55, [2016] 2 S.C.R. 670.

[73] On the bases of the foregoing, I conclude that neither the establishment of the Trust nor the transfer of the Class F Shares to the Trust was a sham. The transactions, and the documents effecting those transactions, accurately reflected the intentions of the parties to those transactions and documents.

B. Were the Transactions Legally Effective?

[74] In *Bank of Nova Scotia v. Thibault*, 2004 SCC 29, the Supreme Court of Canada reproduced article 1260 of the *Civil Code of Québec* and then identified the following requirements for the creation of a trust under Québec law:

> Three requirements must therefore be met in order for a trust to be constituted: property must be transferred from an individual's patrimony to another patrimony by appropriation; the property must be appropriated to a particular purpose; and the trustee must accept the property.[34]

[75] I have considerable difficulty understanding the basis of the Respondent's submission that the creation of the Trust was legally ineffective. The PASF and the evidence clearly indicate that the Trust was created for the benefit of Mrs. Lee in accordance with the requirements of Québec law and that following the creation of the Trust Mr. Paris, as trustee, had control over the property of the trust for the benefit of Mrs. Lee.

[76] Mr. Paris retained trusted professional advisors to ensure that all the formalities for the creation of a trust under Québec law were followed. The Deed was executed on December 10, 2003 in the presence of a Québec Notary and the Deed was filed with the relevant government authority in Québec. Mr. Paris accepted his appointment as trustee of the Trust in the Deed.[35]

[77] The Appellant provided Mr. Paris with a cheque dated December 8, 2003 for $2,000 as the initial settlement on the Trust and that cheque was cashed by Mr. Paris on December 11, 2003, the day after the Deed was executed, and was deposited in the bank account of the Trust opened by Mr. Paris.

[78] On December 10, 2003, Mr. Paris appointed lawyers and accountants of the Trust. The transactions that followed, such as the contribution by the Appellant to the Trust of the Class F Shares, the redemption of the Class F Shares by Briel, the distribution of the income of the Trust from the redemption to the sole beneficiary of the Trust, the issuance by the Trust of a $16,000,021 demand promissory note to

[34] Paragraph 31.
[35] Article 2.1 of the Deed.

Mrs. Lee in payment of the income distribution and the loan of $18,000,000 to Briel, were all contemporaneously approved and documented.[36]

[79] The Respondent submits that "the $2,000 functioned as a token payment; it was the equivalent of a gold coin" and "the $2,000 was nothing more than a transaction cost".[37] During the cross-examination of the Appellant, counsel for the Respondent spent some time focussing on the reason for the nature (cash) and amount ($2,000) of the initial settlement on the Trust. I fail to see the relevance of either fact to the existence of the Trust under Québec law.

[80] I was not directed to any Québec law that would suggest that a Québec trust cannot be settled with cash, nor was I directed to any Québec law that stipulated the value of a settlement on a Québec trust. The Deed states the following: "The settlor hereby makes a gift, inter vivos, of the Initial Property for the benefit of the Beneficiaries".[38] I heard no evidence that contradicts that statement. The definition of "Initial Property" in the Deed explicitly identifies the $2,000 cheque[39] from the Appellant by amount, payee and cheque number.[40]

[81] Mr. Paris testified that at one point because of Trust expenses the balance in the Trust's bank account fell to $1,156,[41] indicating that approximately $850 of the $2,000 was used for the expenses of the Trust. In any event, the Trust was irrevocable and there is no evidence that any portion of the Trust's property reverted to the settlor or was otherwise used for the benefit of a person other than Mrs. Lee.

[82] The evidence does establish that in 2009, after Mr. Paris had been replaced as trustee of the Trust by PLST Holdings, a corporation owned by Mrs. Lee, Briel/VPL stopped paying interest to the Trust. In cross-examination, the Appellant testified that the decision to not pay interest to the Trust was made in conjunction with Mrs. Lee. As of the end of 2017, the loan was still shown as owed to the Trust on the financial statements of VPL.[42] I see nothing in these facts to suggest that the original creation of the Trust should be disregarded as ineffective.

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[36] Exhibit AR-2, Tabs 5, 6, 8, 9, 11, 12, 13, 14, 15, 16, 17, 18, 19 and 20.
[37] Paragraphs 95 and 96 of the Respondent's Written Submissions.
[38] Article 2.1 of the Deed.
[39] Exhibit AR-2, Tab 3.
[40] Article 1.10 of the Deed.
[41] Lines 4 to 7 of page 156 of the Transcript.
[42] Lines 27 to 28 of page 390, lines 1 to 3 of page 391, lines 3 to 28 of page 295 and lines 1 to 17 of page 296 of the Transcript and Exhibits A-10 and A-11.

[83] On the basis of the foregoing, I conclude that the Trust was validly and effectively created under the laws of Québec on December 10, 2003 and remains in existence as of the date of this hearing.

IV. Conclusion

[84] The appeal is allowed and the Reassessments are vacated. The Appellant shall have 30 days from the date of this Judgment to provide submissions as to costs and the Respondent shall have a further 30 days to respond to those submissions. Such submissions shall not exceed 10 pages.

Signed at Ottawa, Canada, this 15th day of November 2018.

"J.R. Owen"

Owen J.

CITATION:	2018 TCC 230
COURT FILE NO.:	2013-2493(IT)G
STYLE OF CAUSE:	VAN LEE AND HER MAJESTY THE QUEEN
PLACE OF HEARING:	Vancouver, British Columbia
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REASONS FOR JUDGMENT BY:	The Honourable Justice John R. Owen
DATE OF JUDGMENT:	November 15, 2018

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